THE ECONOMIC IMPLICATIONS OF THE UNION BUDGET, 1975-76

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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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The Union Budget for 1975-76 was presented by the Finance Minister in the context of an economy which was suffering from a year of unprecedented economic strain and crisis in various sectors.

The failure of the monsoon dealt a severe blow to the Kharif crop in 1974 causing acute problems on the food front and also in the case of commercial crops. The tremendous increase in international oil prices caused severe imbalances and strains in the country's balance of payments. Conditions of international inflation in various countries further accentuated the strain and stress suffered by the Indian economy during this period. It is against this backdrop that the implications of the budget for 1975-76 are analysed.

NATIONAL INCOME STAGNANT

As a result of the drop in the agricultural production caused by the failure of the monsoon in 1974, the country's national income computed at constant (1960-61) prices is estimated by Government to have grown during 1974-75 hardly at the rate of 1% but the final figures may even show a zero or negative rate of growth. The growth of national income during the past years was as follows: 5.7% in 1969-70, 4.9% in 1970-71, 1.4% in 1971-72, a drop of 0.90% in 1972-73, 3.1% in 1973-74 and on the most optimis-

* The author, an eminent economist, is an authority on taxation. This text is based on a public lecture delivered in Bombay, on 3rd March 1975 under the joint auspices of the Forum of Free Enterprise and other organisations.

tic assumptions 1% in 1974-75. The Fourth Five-Year Plan had as its main target a growth rate in national income of 5.7% per annum, but the actual growth rate is now estimated by Government at 2.8%. Even more disturbing are the figures of national income on a *per capita* basis. National income on *per capita* basis at constant (1960-61) prices was as follows: Rs. 335/- in 1964-65, Rs. 343/- in 1969-70, Rs. 351/- in 1970-71, Rs. 348/- in 1971-72, Rs. 337/- in 1972-73, Rs. 340/- in 1973-74 and a slightly lower figure in 1974-75. These figures, therefore, dramatically reveal that *per capita* national income has remained stagnant for more than a decade and has been declining slightly since 1971-72. This is not surprising in view of the fact that the growth of national income remained at constant prices during the Fourth Plan at the rate of 2.8% *per annum* but during this period the population grew at the rate of 2.2% *per annum* so that the official statistics could only claim at best real growth on a *per capita* basis at the rate of half *per cent per annum* during the Plan period. The "Economic Survey" of the Government of India notes that, "since effective solutions for the basic problems of poverty and underdevelopment can be found only through rapid economic growth, our objective must be to gear the economy to a higher growth rhythm than it has been used to in the past". Unfortunately, there was no visible progress in this direction during 1974-75 as has been revealed by the official statistics quoted above. The challenge faced by the policy planners in 1974-75 is to stimulate real growth in the Indian economy. But there are no signs of any concrete steps to tackle this challenge either in the Budget or in any other policy decisions of the Government of India.

AGRICULTURAL PRODUCTION

The "Economic Survey" notes: "India's agriculture seems to have lost the momentum for growth it exhibited in the late sixties". The rate of growth of agricultural production was 4.1% *per annum* from 1967-68 to 1970-71. But in 1971-72, agricultural production actually declined by 4% compared to the previous year, in 1972-73 it declined by 7.1%, in 1973-74 it is estimated to have risen by 9.1%, in 1974-75 it is estimated to be the same as in the previous year or probably declined. The Fourth Plan had as its target an annual rate of growth of agricultural production of 5.6% but the actual rate of growth achieved was only 2.8% *per annum*. Even more depressing are the statistics of total output of food grains. Thus in 1969-70, the output of food grains was 99.5 million tons, in 1970-71 it was 108.42 million tons, in 1971-72 it was 105.17 million tons, in 1972-73 it was 97.03 million tons, in 1973-74 it was 103.61 million tons and in 1974-75 it is estimated to have remained at around 103 million tons. The index of agricultural production was 131.4% in 1970-71 and was only 131.6% in 1973-74; whereas the output of food grains which was 108.42 million tons in 1970-71 has fallen to around 103 million tons in 1973-74. The population during this period has risen by more than 7%. These figures clearly indicate that the *per capita* availability of food stuffs and essential wage goods like vegetable oils has declined in the recent years.

Weather conditions are still the dominant determinant of Indian agriculture. The output of wheat has declined because the Kalyan sona variety has been attacked by rust disease since 1972. Rice output is estimated to have risen at an average rate of 1.2% *per annum* since 1964-65 despite the introduction of high-yielding varieties. The total availability of fertiliser in 1973-74 measured in terms of NPK was 29.8 lakh tonnes as compared with the target in the Fourth Plan of 55 lakh tonnes. More than half of the fertiliser consumed in India is still imported and the fertiliser prices in the international market rose dramatically in 1974. There can be little doubt if Government had freely allowed private entrepreneurs to set up fertiliser factories in the past and had not stood in the way of good big houses like Tatas from producing fertilisers, the present unsatisfactory situation regarding fertiliser output would not prevail.

The kharif crop in 1974 was very poor. Government had to import slightly less than five million tons of food grains in order to maintain minimum levels of nutrition. The rabi crop is expected to be better. The "Economic Survey" for 1974-75 points out that, "with the exception of raw cotton, output of commercial crops in 1974-75 is expected to be lower than in 1973-74."

The shortfall in agricultural production remains the main cause of economic stagnation in the country. The tremendous increase in the population causes shortages of food and leads to continuous inflation. The monsoon unfortunately therefore continues to determine the progress of the country.

INDUSTRIAL PRODUCTION

Between 1960 and 1965, industrial production grew at an average annual rate of 8% but this growth rate declined steeply after 1966. In 1969-70, industrial production rose by 7.4% over the previous year, in 1970-71 by 3%, in 1971-72 by 3.3%, in 1972-73 by 5.3%, in 1973-74 by only half *per cent* and in 1974-75, it is estimated to have risen around 2.5%. The Fourth Plan had a target of industrial growth at the annual rate of 8 to 10% — actually industrial production grew at the average rate of 3.9% *per annum* during the Fourth Plan period.

To a large extent, failure on the agricultural front adversely affected industrial production. The "Economic Survey" for 1974-75 notes that "since agro-industries account for nearly 45% of the weight in the index of industrial production, the sluggishness of production of the commercial crops constituted a major constraint on the rate of growth of industrial production throughout the Fourth Plan period". But this was not the only constraint operating in the industrial field. The expansion of industrial capacity during the past years has been extremely poor. A recent study by the IDBI pointed out that "assuming capacity utilisation at 80 per cent and some unavoidable gestation lags, a sustained increase in industrial production at the rate of 9% *per annum* is possible only with a capacity increase of about 10% *per annum*. However, according to the same study, capacity in major Indian industries grew during the Fourth Plan period at an average annual rate of 3.8%". This clearly indicates that investment in Indian industry was totally inadequate to sustain a high rate of growth. The Fourth Plan has envisaged that total public sector plan outlay in industry and minerals would be Rs. 3,338 crores in terms of 1968-69 prices. The actual outlay in terms of current price did not even exceed Rs. 3,000 crores indicating that in real terms there was tremendous shortfall in industrial investment. Similarly, in the private sector there were tremendous shortfalls in the creation of new industrial capacities on account of a steep rise in Plan costs and lack of savings.

Even the utilisation of existing industrial capacity in recent years has been very poor. The main cause has been shortage of agricultural raw materials as well as huge shortfalls in power or electricity supplies. The Fourth Plan had envisaged an addition of 9.3 million KW to capacity during the five year period. But the actual achievement in respect of the generation of electricity was less than half the target. Industries also suffered from shortages of coal, steel, cement, etc. which adversely affected their production. Even though the Government claims that industrial licensing was simplified, it cannot be denied that there were considerable delays in industrial licensing and the MRTP Act acted as a great bottleneck in the implementation of large industrial projects by the so-called "monopoly houses". In this environment, it is small wonder that the "Economic Survey" sums up the prospects for industrial growth as follows: "It will be unrealistic to assume that a major break-through in the rate of growth of industrial production is just round the corner."

EMPLOYMENT

Total employment in the public sector in March of each year was as follows: 100.95 lakhs in 1969, 103.74 lakhs in 1970, 107.31 lakhs in 1971, 113.05 lakhs in 1972, 119.75 lakhs in 1973, and 124.87 lakhs in 1974.

Total employment in the private sector was as follows: 65.3 lakhs in 1969, 67.0 lakhs in 1970, 67.6 lakhs in 1971, 67.7 lakhs in 1972, 68.5 lakhs in 1973 and 67.7 lakhs in 1974.

Thus total employment in private sector has been completely stagnant and the increase in employment in the public sector is only small.

The figures of the total number of persons seeking jobs as shown on the live registers of Employment Exchanges at the end of June each year were as follows: 56.88 lakhs in 1972, 75.96 lakhs in 1973 and 83.54 lakhs in 1974.

The number of educated unemployed registered with the unemployment exchanges were 26.11 lakhs in 1972, 35.29 lakhs in 1973 and 40.32 lakhs in 1974.

Thus despite a substantial rise in the total population the avenues of employment have remained stagnant during the past few years indicating that there has been a substantial increase in the unemployment problem.

SAVINGS AND INVESTMENTS

Savings and investments as a proportion of national income declined in 1973-74 as compared to 1972-73. Domestic savings were estimated around 10% and investments around 11% of national income. The "Economic Survey" notes that in these areas there is "unlikely to have been any improvement in 1974-75". The steep rise in the price level has undoubtedly affected the savings in the Indian economy. As mentioned earlier, public sector investment in real terms declined significantly and gross capital formation in corporate sector rose by less than 9% in 1973-74 compared with 13.5% in the previous year.

The capital market crashed after July 1974 when various ordinances to restrict the payment of dividends, wages, dearness allowances, etc. were introduced. Thus "The Financial Express" equity index crashed from 251.21 down to 163.87 and even now it is hovering round 190. The new issue market also collapsed. It has been very difficult for the new entrepreneurs to raise the funds for new industrial undertakings.

PRICE BEHAVIOUR

The Indian economy continued to reel under the onslaught of unprecedented inflation during the past year. Thus the index of wholesale prices rose as follows: 6.2% in 1970, 3.9% in 1971, 7.8% in 1972, 19.2% in 1973 and 27.3% in 1974. The rise in prices at the end of December 1974 compared with December 1973 amounted to 21%. Food article prices rose in 1974 by 26.1% and the rise at the end of December 1974 as compared with 1973 amounted to 22.9%. Prices of fuel, power, light and lubricants rose by 35.5%, prices of chemicals rose by 44.8%, prices of machinery rose by 44.1% as compared with prices of manufacture which rose only by 17.6% as between December 1973 and December 1974.

Prices reached their peak in the third week of September 1974 and are estimated to have fallen by 5% between September and December 1974 as a result of various ordinances and MISA promulgated by the Central Government. Government tried to control price rise through public distribution of essentials, compulsory procurement of foodgrains, control on prices of vanaspati, drugs, etc. However, it realised that many of these controls in the absence of production only caused further shortages in the economy and by the end of the year it was forced to decontrol a number of items.

BUDGETARY TRENDS

The annual budget of last year (1974-75), the second Finance Act 1974, the increase in railway fares and freight during the past financial year and the increase in the postal rates are estimated to raise an additional revenue of Rs. 690 crores in 1974-75 and to yield in a full year Rs. 935 crores. The various States raised additional resources estimated to yield Rs. 358 crores in 1974-75 and Rs. 540 crores in a full year. Thus the past year has witnessed a gigantic effort to mobilise resources amounting to not less than Rs. 1,048 crores between the Centre and the States in 1974-75 and amounting to Rs. 1,475 crores in the coming full year. Unfortunately, most of the resources thus raised were frittered away in unproductive expenditure. The "Economic Survey" for 1974-75 notes that "a large part of these resources have been absorbed by inescapable commitments of non-developmental, though by no means non-essential, expenditure".

The only bright feature on the budgetary front is that the commercial public sector corporations earned a gross profit before tax of Rs. 150.15 crores in the year ended 31st March 1974 and they are expected to earn in the year ending 31st March 1975 a profit of Rs. 273.24 crores. This is a healthy development which should undoubtedly be welcomed. It should ease to some extent the pressure on the budgetary front in the coming years.

MONETARY DEVELOPMENTS

One of the most unfortunate developments during the past few years has been the inexorable increase in money supply which went up steeply throughout the Fourth Plan period. National income in real terms rose negligibly at an average rate of less than 3% *per annum* during this period. But in 1969-70 money supply rose by 10.8%, in 1970-71 by 11.2%, in 1971-72 by 13.1%, in 1972-73 by 15.9% and in 1973-74 by 15.3%. Between 31st March 1974 and 17th January 1975, the growth of money supply is estimated to have slowed down to only 4.3% as a result of the tight money policy and the credit squeeze. There can be no doubt that the tremendous inflation which took place in the past five years is largely due to the continuous increase in the money supply without a corresponding increase in production.

BALANCE OF PAYMENTS

There was a sharp deterioration in the foreign exchange position of the country during 1974-75. Total foreign exchange reserves at the end of December 1974 although shown at a level of Rs. 949 crores were computed without taking into account the fact that we had drawn from the International Monetary Fund Rs. 488.1 crores upto December 1974 and the "Economic Survey" predicted that in the final quarter of 1974-75 there was likely to be a "significant deterioration in India's reserve position". The country's imports rose dramatically because of imports of foodgrains amounting to around five million tons, the quadrupling of the prices of oil and petroleum, large-scale imports of fertilisers, increased prices in metals, etc. The total import bill which was Rs. 1,867.4 crores in 1972-73 and had risen to Rs. 2,920.9 crores in 1973-74, rose in the first six months of the last financial year, that is, April 1974 to September

1974, to Rs. 1,933 crores as compared with only Rs. 1,111.7 crores in a similar period in the previous year.

Exports did rise as a result of the inflation in the prices of various commodities in the world market. But despite this, the trade gap widened against India during the year. Thus, exports which amounted to Rs. 1,970.8 crores in 1972-73 and Rs. 2,483.2 crores in 1973-74 rose to Rs. 1,514.6 crores in the first six months of the last financial year (April to September 1974) as compared with a figure of Rs. 1,074.8 crores in a similar period of the previous year. As a result of these developments, a critical stage has been reached in our balance of payments and foreign exchange reserves which requires a tremendous increase in exports in the coming year if we are not to be forced to devalue the Indian Rupee in the near future.

BUDGETARY APPROACH

The Finance Minister in his budget speech has stressed that the budget is an important tool for reaching our socio-economic goals. He said that his immediate concern was to bring inflationary pressure under check. But he emphasised the importance of economic growth by saying that "the problems of poverty in our country cannot be solved by merely holding the price line. We can meet them only through growth. A rapidly growing economy is the best insurance against perpetuation of poverty; indeed it is the only solution." He stated further that "our ability to meet the minimum basic needs of our people depends crucially on the trend in agricultural production" and, therefore, acknowledged "the claims of agricultural growth as the first charge on our developmental resources. Modern agriculture is inter-linked with industry. Fertilisers, pesticides, agricultural implements and equipment, besides supply of power, determine agricultural productivity, as much as seeds and water. The sectors of our industry which supply these vital inputs to our agriculture, therefore, merit the highest priority."

The Finance Minister has stated that "next only in importance to the agricultural sector is the energy sector". He has stressed the importance of increasing the generation of electricity, increasing output of coal and oil. Thus the general approach spelt out by the Finance Minister in Part A of the budget speech is unexceptionable. Unfortunately, the budget does very little to reach the goals outlined in the first part of the budget speech.

BUDGETARY POSITION

The budgetary deficit for 1974-75 which was originally estimated at Rs. 126 crores is now estimated to have risen to Rs. 625 crores despite the massive mobilisation of resources undertaken not only by the last year's budget but also by the second Finance Act as well as through the raising of railway fares and freight and postal rates during the past year. The Finance Minister has explained this increase in the deficit by highlighting some of the increases in respect of expenditure estimated in the last budget (for 1974-75). Thus that budget had provided for only Rs. 100 crores on account of food subsidy which is now estimated to have cost Rs. 295 crores. Secondly, the budget did not contain any provision for assistance to the States for drought and abnormal conditions which now is shown to have cost Rs. 161 crores. Thirdly, the provision of dearness allowance on pay of Government employees was grossly under-estimated and actually involved Rs. 110 crores more than the budget estimates. Fourthly, defence expenditure exceeded the budget estimate by Rs. 242 crores. Fifthly, public sector enterprises required special assistance beyond the budget estimates amounting to Rs. 126 crores. Sixthly, outlays on fertiliser transactions amounted to Rs. 290 crores whilst the budget contained no provision for such expenditure. Finally the expenditure on the Central Plan rose by Rs. 74 crores beyond the budget estimates.

As a result of the above mentioned increases in the expenditure, the deficit is estimated at Rs. 625 crores despite the terrific buoyancy in tax revenues. Thus the total tax revenue, which was estimated in the budget of 1974-75 at Rs. 5,498 crores is now shown in the revised estimates at Rs. 6,128 crores — a rise of Rs. 630 crores. In this connection, it is also important to note that although the rates of personal income-tax were slashed drastically in the budget for 1974-75, the yield from personal income-tax which was estimated at Rs. 709 crores (without taking into account the anticipated loss of Rs. 36 crores on account of the cut in the tax rates) has actually been exceeded and the revised estimates of the yield from income-tax are now shown at Rs. 747 crores in 1974-75 and at Rs. 800 crores in the budget for 1975-76. The cut in the rates of income-tax in direct per sonal taxation yielded a handsome increase in revenue to the Government indicating that a pragmatic tax policy in the coming years should attempt reduction in the rates of personal and other direct taxes in order to secure higher tax revenues.

HIGHER DEFICIT PREDICTED

At current levels of taxation, the Finance Minister has estimated the total budgetary deficit for 1975-76 at Rs. 464 crores. He has proposed additional taxation which is estimated to yield to the Centre revenue of Rs. 239 crores, leaving a gap of Rs. 225 crores uncovered. This gap of Rs. 225 crores for 1975-76 is likely to be a gross underestimate because of the following factors: First, the dearness allowance for the Government staff is based on the index figure of 272. This figure had already been exceeded in 1974 and the budget estimates are therefore based upon the assumption that the prices will fall and will *not* rise at all in the coming year. It is likely that inflationary pressures during the coming year will cost the Government Rs. 80 to Rs. 100 crores more on account of dearness allowance to be paid to Government staff. Second, fertiliser transactions are estimated in the coming year to cost only Rs. 140 crores. It is likely that they will amount to over Rs. 250 crores. Third, oil credits are assumed to give the budget support of Rs. 230 crores. It is difficult to estimate whether this figure will be realised. Fourth, the budget provides for a special borrowing from the Reserve Bank of India of Rs. 100 crores to be taken out of the amounts got from freezing additional emoluments and dearness allowance and the compulsory deposit schemes. Since these measures were taken to immobilise such amounts deposited in the Reserve Bank of India the withdrawal of the same is just a piece of window-dressing to reduce the budgetary deficit which goes against the original goals of these schemes! Fifth, the budget assumes that prices will remain stable throughout the coming year. This is an unrealistic assumption. In the absence of further measures to mobilise resources during the coming year the budget deficit is likely to reach a figure in excess of Rs. 500 crores which will further fan the inflationary pressure operating in the Indian economy.

PLAN OUTLAYS

The budget provides for total Plan outlays by the Central Government and the States of Rs. 5,960 crores. The Finance Minister pointed out that this represented an increase of 23% over the 1974-75 Plan outlay of Rs. 4,844 crores. However, such an increase in monetary terms may amount to little in real terms if it is adjusted for inflation which is likely to occur in the coming year and which may push up prices between 15% and 25%. Thus at best the total Plan outlay may involve only a small increase in real or physical terms as compared with the previous year's Plan outlay. Some of the components of the coming year's Plan outlay are undoubtedly welcome. Thus investment in agriculture is to be stepped up to Rs. 270 crores from last year's figure of Rs. 193 crores and in fertiliser production to Rs. 276 crores from previous year's figure of Rs. 192 crores. A massive effort is to be made in the area of electrification for which Rs. 140 crores is provided in the Central Plan and Rs. 900 crores is to be provided in the Plans of various States. Coal production is to get Rs. 229 crores against the previous year's figure of Rs. 141 crores. The Plan outlay in petroleum and petro-chemicals is to be stepped up to Rs. 170 crores from the previous year's outlay of Rs. 60 crores. Industry and minerals are budgeted to get an outlay of Rs. 1,221 crores against last year's figure of Rs. 729 crores. These increases in the Plan outlays in priority areas are undoubtedly steps in the right direction but as mentioned earlier they may in real terms represent only a small or modest increase because of the rise in prices likely to occur in 1975-76 and, therefore, they will fail to speed up growth and development on a massive scale.

BUDGET PROPOSALS

The Finance Minister has relied primarily on a wide range of excise duties which are estimated to yield Rs. 250.47 crores in 1975-76 of which the States' share will be Rs. 55.66 crores leaving the Centre with a nett yield of Rs. 194.81 crores. He has also proposed changes in the customs duties to yield Rs. 34.05 crores to the Centre.

In the field of direct taxation a number of fairly small changes have been attempted which are estimated to yield to the Centre in 1975-76 Rs. 8.24 crores. Thus the approach towards the budget continues the trend which has operated during the last decade of primarily relying on a large variety of excise duties to raise the revenues in the budget despite the fact that such excise duties fuel further price rises and fan the fires of inflation as has happened during the past many years.

EXCISE DUTIES

The Finance Minister has proposed a large number of excise duties to raise the bulk of the additional revenues required by him. Some of the main excise duties may be mentioned:

Excise duties on sugar and khandsari have been increased substantially to yield Rs. 49.85 crores. The Finance Minister has justified this levy by saying that he hoped to curb the consumption of sugar within the country in order to promote the export of this valuable item, presumably assuming that the full excise duty will be passed on to the consumers through an increase in the prices of sugar. Excise duties on petroleum and petroleum products are enhanced to yield Rs. 26 crores in the hope that the entire duty will be passed on to the consumer and will, therefore, curb the use of petroleum products which have to be imported. Excise duties on tobacco and tobacco products have been raised to yield Rs. 26.88 crores. These duties are likely to be passed on completely to the consumer. Excise duty on tea has ben raised to yield Rs. 3.40 crores. Excise duties on rayon and synthetic yarn fabrics have been shifted to the yarn. The additional burden of excise duty placed on rayon and synthetic yarns and also on cotton yarn is expected to yield Rs. 49.10 crores.

Additional excise duties on dyestuffs are estimated to yield Rs. 4.50 crores. These duties will undoubtedly push up the prices of all types of cloth.

Paper and boards are subject to enhanced excise duties which will yield Rs. 9.80 crores.

Increased excise duties have been levied on a number of items which enter into the construction or equipment of buildings. Thus excise duty on non-electrical goods and aluminium is stepped up sharply to yield Rs. 15 crores, excise duty on cement is stepped up to yield Rs. 15.95 crores, excise duties on electric wires and cables are increased to yield Rs. 2.80 crores, excise duties on glass and glassware are increased to yield Rs. 3.80 crores, excise duty on electric fans is raised to yield Rs. 1.50 crores and the excise duty on airconditioners is raised to yield Rs. 3.60 crores. All these duties will sharply push up the cost of construction in the coming year as they will be undoubtedly passed on to the consumer in most cases.

Finally, the Finance Minister has proposed a new excise duty of 1% to be levied on all goods which are meant for resale and which are not elsewhere specified in the excise duty schedule. It has been provided that the factories having less than 50 workmen will be exempt from this duty and there will be no countervailing import duty for this measure. Electric power, food, government factories, components and intermediates made within the same factory for use in it are to be exempted from this duty. This new excise duty at the rate of 1% is estimated to yield Rs. 24 crores. Initially its impact may appear to be small but it will involve a tremendous amount of administrative work and also provide the Government with new data and fresh ideas for widening the excise duty coverage in coming years.

CUSTOMS DUTIES

The budget proposes an increase in the customs duty of

Rs. 3,500 per tonne on copper and Rs. 2,125 per tonne on zinc to yield additional revenues of Rs. 24.50 crores. The adjustments in countervailing duties on account of new excise duties are estimated to yield Rs. 9.55 crores, giving a total yield of customs duty of Rs. 34.05 crores. Here again these duties will be passed on to the consumers and will further raise prices.

CENTRAL SALES TAX

The Finance Minister has said that he would raise the central sales tax from 3% to 4% effective 1st July 1975. This will push up prices of all commodities throughout the country. This new levy is expected to yield Rs. 38.25 crores in 1975-76 to the States and Rs. 1.75 crores to the Centre from its Union Territories in the current financial year. In a full year this increase in the sales tax will yield probably over Rs. 60 crores. This, therefore, represents another massive dose of indirect taxation which will further accelerate inflation in the country. Despite the Government denials of the inflationary impact of the budget it is quite clear that the prices were raised immediately after the budget in order to pass on the new levies to the consumers. The tremendous dose of indirect taxes together with the massive budgetary deficit mentioned earlier will lead to a price rise of at least 15% and if the monsoon fails the price rise could easily reach 25% over the previous year!

DIRECT TAXATION

The Finance Minister has proposed a series of small changes in personal and corporate taxation which at best can be described as marginal adjustments. Some of the important changes are analysed here. In the field of personal taxation, he has withdrawn the exemption from income-tax under Section 80K of dividends received by shareholders from new industrial undertakings like hotels and ships. Such new undertakings started after 31st March 1976 will not be able to declare dividends exempt from income-tax in the hands of their shareholders. The withdrawal of this concession largely negates the other concession which the Finance Minister has proposed to encourage new industrial floatations.

The deductions for computing taxable income of life insurance premia and other savings are slightly increased to encourage individuals to put their savings into these forms of investment — this is excellent.

To encourage employees not to withdraw from the Government Provident Funds, a bonus of 3% has been proposed in respect of employees drawing a salary of less than Rs. 500 per month and 1% for employees drawing more than Rs. 500/- per month if they do not make any withdrawals from the Government Provident Funds during the year. A similar concession has not been extended to employees in the private sector which is inexplicable and unfair.

Middle class families, defined as those earning upto Rs. 12,000/- per year, are to get a deduction of Rs. 1,000 in respect of education expenses for degree and post-graduate studies in medicine, engineering and technology and a deduction of Rs. 500 for other degrees and diplomas per child subject to a maximum allowance for two children.

Retrenchment compensation given to workmen is to be exempted from income-tax up to Rs. 20,000. House rent allowances and leave allowances of salaried employees are slightly liberalised in the budget. These small concessions in the field of income tax are undoubtedly to be welcomed.

WEALTH TAX

The Finance Minister has proposed that the equity shares of new industrial undertakings which are issued after 28th

February 1975 will be exempt from Wealth Tax for a period of five years if the industries are covered by the Ninth Schedule of the Income-Tax Act. The Ninth Schedule covers mainly heavy and priority industries and this concession, it is hoped, will encourage individuals to invest in shares of new industrial undertakings in the priority sector where there is a long gestation period. But this exemption should be extended to cover shares of new companies floated to run small scale industries which are on the priority list of the government.

Standing trees are to be exempt from Wealth Tax. The exemption for a personal car has been raised from Rs. 25,000 to Rs. 30,000 for purposes of the Wealth Tax.

CORPORATE AND BUSINESS TAXATION

The rate of income-tax on closely held industrial companies has been raised from 55% to 60% of their total income if they have a profit of more than Rs. 2 lakhs. This will severely hit many small companies including many small-scale industries who will, therefore, have to pay increased tax.

The Finance Bill provides that only 85% of the interest in the deposits taken from the public will be entitled to deduction in computing the taxable income of companies. Since 15% of the interest paid on public deposits will not be deductible for income-tax purposes, this amendment will push up the tax burden of companies and will make the interest burden nett after tax higher in respect of public deposits. The only justification for this appears to be to protect the banking system and to discourage the public from puting deposits with companies.

The Finance Minister has extended the tax holiday on income from new industrial undertakings (hotels and ships) launched after 31st March 1976 for a further period of five years. Under the provisions of Section 80J of the Income-Tax Act new industrial undertakings were entitled to exemption from income-tax for the first five years of their operations upto 6% of their capital. It is now proposed to give an exemption from income of 7½% of the capital employed in respect of new industrial undertakings launched after 1st April 1976. The Finance Minister has claimed that this increase from 6% to 7½% of the capital employed for calculating the profits exempt under Section 80J would compensate for the abolition of these benefits under Section 80K discussed earlier. But this claim is surely far-fetched and may have some validity only in respect of few shareholders whose personal rate of income-tax is less than 20%, assuming that companies distribute all the profits covered by Section 80J. For most shareholders whose marginal rate of personal income tax exceeds 20% the abolition of tax exemption of dividends under Section 80K will *not* be compensated by raising the rate of tax exempt profits for new industrial undertakings launched after 1st April 1976.

A few further concessions are being offered in order to encourage industrial growth. It has been provided that inter-corporate dividends will be exempt from income-tax from new companies formed and registered after 28th February 1975 for manufacture of fertilisers, pesticides, paper pulp, newsprint and cement. Pesticides have been included in the Ninth Schedule of the Income-Tax Act. The Finance Minister hopes that these concessions will encourage people to put up new companies in these fields which have a long gestation period.

The development rebate on ships has been extended up to 1st January 1977 for ships ordered before 1st December 1973.

Income from livestock breeding, poultry and dairy farming is to be exempted up to Rs. 10,000 per year only.

Depreciation on imported cars purchased after 28th February 1975 is to be totally disallowed whilst full depreciation is to be allowed on Indian cars.

Under conditions of industrial stagnation which have been outlined earlier, these small changes in direct taxation will only further extend stagnation in the Indian economy — they are not fundamental or large enough to push growth in the economy on a new scale.

REVERSAL OF COURT JUDGEMENTS

The Finance Minister has introduced in the budget a most deplorable trend of reversing judgements of courts in cases where they have gone against the Government. Thus in the case of Commissioner of Income-Tax *versus* D. R. Pathak, the Bombay High Court had held that allowances like the compensatory city allowance were exempt from income-tax. The Finance Bill now attempts to reverse this judgement with retrospective effect from 1st April 1962, which surely is deplorable.

In a recent judgement, the Bombay High Court had correctly held that the amount of past gratuity liability should be allowed as a deduction on an actuarial basis in computing taxable income. The Finance Bill provides that no deduction on account of past gratuity liability will be permitted unless such amount is paid into an approved gratuity fund. This provision is made retrospective from 1st April 1973 and in effect will impose an inequitable terrific tax burden on all companies. It is estimated that the additional tax burden as a result of the provision may amount to Rs. 60 crores.

CONCLUSIONS

The budget fails to spur growth. It is doubtful whether growth of new industries will occur on a massive scale by extension of the tax holiday under Section 80J, by the exemption of certain intercorporate dividends, by the exemption of new equity shares from wealth tax, etc. Many new companies will not be floated and production will not increase rapidly in the coming years.

Agricultural production will continue to be determined by the monsoon and will remain a gamble on the weather.

Industrial production is not likely to rise spectacularly in the near future in the absence of further measures to rectify the present situation.

The budgetary gap and the various duties will push up prices further and prices are likely to rise between 15% and 25% during the coming year.

The stock market is not likely to rise dramatically in the absence of a bumper monsoon. The new issue market will also remain sluggish. The Finance Minister has said in his budget speech that the restriction on payment of dividends will be removed by allowing the companies to pay dividends in excess of the present limits but only in two annual instalments after the present Restrictions on Distribution of Dividends Act expires. This is no real concession because companies could have paid any dividend after the expiry of the Act without even making such payments in two instalments as now suggested by the Finance Minister. Thus this concession has failed to enthuse the stock markets. The budgetary deficit is likely to exceed Rs. 500 crores. The foreign exchange situation will remain critical and a devaluation of the Indian Rupee after 1976 should not be ruled out.

It is indeed sad that in a situation crying out for growth and progress, the Finance Minister has missed the golden opportunity to take bold and dramatic steps to resume growth. He should have cut direct taxes. The provision for the Plan should have been much larger. The industrial policy should have been changed in order to make it more pragmatic and dynamic. In the absence of such measures, the economy will continue to stagnate and drift.

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.

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