THE ECONOMIC IMPLICATIONS OF THE UNION BUDGET, 1976-77

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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 1976-77 was presented by the Finance Minister in the context of an economy which had begun to revive as a result of excellent agricultural production coupled with the successful reversal of inflationary pressures.

An excellent monsoon resulted in a record *Kharif* crop in 1975 which is expected to be followed by very good *rabi* crop. This has boosted the production of food crops as well as commercial crops to record levels. This success on the agricultural front has helped to break the back of severe inflationary pressure which had plagued the Indian economy during the past years and prices actually began to decline in most sectors. The most remarkable feature of the Indian economy in 1975-76 was the successful control of inflation at a time when inflation was rampant in most countries of the world. The economic implications of the Budget for 1976-77 can be analysed in the context of this scenario which prevailed during the year in India.

NATIONAL INCOME RESUMES GROWTH

As a result of failure of the monsoons and the consequent agricultural stagnation, the national income of

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India between 1970-71 and 1974-75 rose at an extremely disappointing rate. Thus the rate of growth of national income during the Fourth Plan period averaged only 3.3% against the target of 5.7% per annum. National income at constant (1960-61) prices is now estimated to have resumed its growth and risen by 5.5% in 1975-76 over the previous year. Thus the growth of national income at constant prices during the past years was as follows: 5.2% in 1970-71; 1.8% in 1971-72; a drop of 1.5% in 1972-73; a rise of 5% in 1973-74; 0.2% in 1974-75 and an estimated figure of 5.5% in 1975-76. Since the population of India rose from 538.9 million in 1970 to 597.9 million in 1975, the *per capita* national product actually fell slightly between 1970-71 and 1974-75. The *per capita* net national product at constant (1960-61) prices was Rs. 351.8 in 1970-71; Rs. 350.2 in 1971-72; Rs. 337.6 in 1972-73; Rs. 347.2 in 1973-74 and Rs. 341.4 million in 1974-75. As a result of resumption of growth in national income, the *per capita* national product in 1975-76 is also estimated to have risen. Thus the *per capita* national product at constant prices rose during the Fourth Plan period only at the average rate of 1.2% per annum which is an indication of the stagnancy and strains through which the Indian economy passed during the past few years and from which it appears to be just emerging now.

"The Economic Survey for 1975-76" commenting on these trends sounds a note of optimism for future by stating that "considering the efforts that are now being made to accelerate the pace of agricultural production and to improve the performance of the public sector, it is likely that in the next two or three years, there will be a substantial improvement in the growth performance of the economy as compared with past trends." The Union

Budget for 1976-77 makes a heroic effort to push the Indian economy into a period of faster growth in the coming years.

AGRICULTURAL PRODUCTION

The "Economic Survey" notes that "the sluggishness of India's agricultural sector is indicated by the fact that from 1970-71 to 1974-75 there has hardly been any increase in the index of agricultural production." Thus the index moved as follows: it was 131.4 in 1970-71; 130.9 in 1971-72; 120.4 in 1972-73; 133.4 in 1973-74 and 129.3 in 1974-75. These unsatisfactory trends are expected to be reversed during 1975-76. It is estimated that the index of agricultural production will rise by about 8% in 1976-77. Similar trends have prevailed also in respect of production of foodgrains. Thus the production of foodgrains was 108.42 million tons in 1970-71; 105.17 million tons in 1971-72; 97.03 million tons in 1972-73; 104.66 million tons in 1973-74 and 101.06 million tons in 1974-75. In 1975-76 production of foodgrains is expected to rise by almost 12% to a record figure of between 113 and 114 million tons.

The *Kharif* crop in 1975 is estimated to have yielded 70 million tons of foodgrains and it is expected that the *rabi* crop in 1975-76 will yield between 43 and 44 million tons, which represent all-time record figures. This increase in agricultural production in 1975-76 is largely due to an excellent monsoon whereas the failures on the agricultural front between 1970 and 1974 were due to the erratic behaviour of the monsoons during that year. The "Economic Survey" frankly admits that "the improved prospects for agricultural production in 1975-76 have greatly helped to control inflationary pressures in the economy." There is clearly no scope for complacency in the production of foodgrains and all efforts must be made to improve the agricultural production. Thus it may be noted that the population of India in 1969 was 527 million whilst the production of foodgrains during 1969-70 amounted to 99.50 million tons, giving a *per capita* foodgrain production of 0.18 ton per person. In 1975, the population of the country had risen to 597.90 million whereas the production of foodgrains in 1975-76 is estimated at only 114 million tons giving a *per capita* foodgrain production of 0.19 ton per person.

These low figures of *per capita* production of foodgrains highlight the urgency of increasing foodgrains and controlling the population in the coming years. The strategy of the Government in respect of agricultural growth continues to be to provide adequate supply of water, encourage liberal use of fertiliser and progressive improvement of the seeds used by the farmers. The recent growth in the irrigation potential has not been satisfactory and special efforts have to be made in the coming year to achieve the target under the new economy programme. Similarly the consumption of chemical fertilisers in 1973-74 was 28 lakh tonnes and in 1974-75 it was 26 lakh tonnes. This was due to unfavourable weather conditions in those years as well as a steep increase in the price of fertilisers. The Government is attempting to reverse this trend by cutting the price of fertilisers. The prices of fertilisers were cut twice before the Budget was presented and have been cut further as per the announcement in the Finance Minister's Budget speech and the subsequent announcements of the Government. These are steps in the right direction which once again should spur the use of fertilisers.

The Government is also attempting to improve the quality of seeds through research and the setting up of projects in various states to spur the growth in this area. It has been announced that regional rural banks will be set up in order to finance the farmers so as to create an environment in which agricultural production can steadily increase in the coming years.

The breakthrough in the agricultural front has been largely responsible in the resumption of growth in the national income during 1975-76. It has also improved the buffer stocks available from the public sector agencies who are now reported to be having 11 million tonnes of foodgrains in stock, which is adequate to meet any shortfalls which may occur in the near future as well as to control the prices of foodgrains. This improvement in the agricultural production has laid the foundation for the resumption of growth in the Indian economy in the coming years and once again highlights the importance of agriculture in the economy of the country.

INDUSTRIAL PRODUCTION

The very low growth of industrial production during the years 1970 to 1974 reflect the condition of stagnancy prevailing in the Indian economy. Thus the index of industrial production grew by 3% in 1970-71; 3.3% in 1971-72; 4.4% in 1972-73; declined by 0.2% in 1973-74 and grew only by 2.5% in 1974-75. The resumption of growth in the Indian economy in the first six months of 1975-76 is indicated by industrial production having grown by 3% and for the balance of the year it is estimated to have grown by 5%. So for the year as a whole, industrial production is estimated to show a growth rate of 4.5%.

The output of capital goods showed an upward trend.

But there was a steep decline in the production of cotton textiles, jeeps, motor cars, air conditioners, cigarettes, radio receivers, electric fans, dry cells and plastics. The Finance Minister has attempted to reverse these trends by cutting excise duties on most of these items so as to revive the demand for them. The "Economic Survey" correctly points out that there are four sources of demand. First, the public sector investment stimulates the demand of machinery and equipment. The large Plan outlay in 1975-76 was responsible for the healthy demand for these items. Secondly, the export demand for industries like cotton textiles and jute was severely affected by the recession in the world trade and in the international market. Thirdly, consumers' demand for industrial goods was adversely affected by the sluggishness of the economy as well as the squeeze on the budgets of the middle class and upper middle class living in the urban areas. Fourth, there is a well-known inventory cycle which encourages hoarding during an inflationary period. The curbing of inflation resulted in dishoarding of goods leading to a drop of prices and demand for the same.

The resumption of growth in the Indian economy should spur industrial production, but the "Economy Survey" correctly points out that "sustained increases in industrial production can be secured only through large exports and improved productivity in agriculture, backed up by measures designed to increase investment in the priority sectors of the economy."

Industrial investment appears to have remained sluggish during the past years from the fragmentary data available on it. The Government has realised that the steep increase in the capital costs of new plant and equipment has not only affected new investment but has also affected the modernisation and replacement of existing equipment. It is attempting to tackle this problem in different ways including through introduction of the investment allowance. Industrial licencing policies have also been relaxed considerably by delicencing 21 industries and allowing industries plagued by recession like car industry to diversify their production.

The Emergency has led to significant improvements in labour relations in the recent months which should create conditions favourable for the growth of industrial production.

EMPLOYMENT

The problem of unemployment continues to remain one of the most difficult ones in the Indian economy. The population of the country rose from 538.9 million in 1970 to 597.9 million in 1975. During this period, employment in the public sector rose very slightly. Thus a number of people employed in the public sector at the end of March was as follows: 103.74 lakhs in 1970; 107.31 lakhs in 1971; 113.05 lakhs in 1972; 119.75 lakhs in 1973; 124.86 lakhs in 1974 and 128.38 lakhs in 1975. Thus there has been an increase of about 2% in employment in the public sector in the past year. Employment in the private sector during these years has remained completely stagnant. Total employment in the private sector at the end of March was as follows: 67 lakhs in 1970; 67.6 lakhs in 1971; 67.7 lakhs in 1972; 68.5 lakhs in 1973; 67.9 lakhs in 1974 and 68.0 lakhs in 1975. Taking into account the increase which occurred in the population of the country, these figures indicate that the problem of unemployment remains acute. The "Economic Survey" points out that "the number of job seekers on the Live Registers of

Employment Exchange at the end of September 1975 stood at 92.54 lakhs, that is 7.1 per cent more than a year ago. This represents some deterioration of employment situaction." However, it expresses the hope that the new economic programme would provide special employment opportunities for the educated youth filling up vacancies of apprentices in various industries.

SAVINGS AND INVESTMENTS

The "Economic Survey" points out that "the provisional data available from the Central Statistical Organisation show that net domestic savings expressed as a percentage of net national product at current prices declined from 14.8 per cent in 1972-73 to 13.6 per cent in 1973-74 and to 13.2 per cent in 1974-75". However, it expresses the hope that there will be some increase in the savings ratio in 1975-76.

Similarly the "Economic Survey" points out that "the Central Statistical Organisation's estimates also show that the net investment as a percentage of net national product at current prices which declined from 15.5% in 1972-73 to 14.4% in 1973-74 further declined to 14.2% in 1974-75". But it comments that the successful implementation of the Annual Plan for 1975-76 will lead to an increase in the ratio of investment to national income. The Survey correctly highlights that in order to achieve higher rates of growth in the years to come a progressive increase in the domestic saving is absolutely essential.

The capital market which had crashed after July 1974 when various ordinances to restrict the payment of dividends, wages and dearness allowances were introduced continued to be relatively stagnant. When the ordinances were introduced in 1974, the Financial Express equity index had crashed from 252.21 to 163.87. In 1975, it moved between a low 165 and high of 195 and in 1976 it moved between a low of 192 to a high of 219. Under these conditions, it was very difficult for new entrants to raise funds for new industrial ventures during the past two years.

PRICE BEHAVIOUR

The most remarkable feature of the economic scene in 1975-76 was the persistent declining trend of prices which first started in the second half of 1974-75. This is indeed a unique achievement taking into account that inflationary pressures continued in most countries of the world and India suffered a severe deterioration in her terms of trade since 1973 due to sharp increase in import prices of fuel, food and fertilisers. The success of the Government in controlling and reversing the trend of inflation must be highlighted as a remarkable achievement.

Thus the index number of wholesale prices rose as follows: 5.5% in 1970-71; 4.0% in 1971-72; 9.9% in 1972-73; 22.7% in 1973-74; 23.1% in 1974-75; but in 1975-76 it is estimated to have fallen by 2.4%. Thus the index declined from a peak of 327.7 in September 1974 to a low of 294.4 by December 1975. Similarly, the All-India Workers' Consumer Price Index reached in October 1974 a peak of 335 but by December 1975 it had declined to 306 and is now standing at around 298.

The fall in the consumer prices was definitely less than the fall in wholesale prices but nevertheless the reversal of severe inflationary pressures which had plagued the Indian economy for the past two years was a notable feature of the Indian economic scene during the past years and should create conditions favourable for the resumption of growth in real terms.

The main fall was in the prices of industrial raw materials, foodgrains, edible oil, etc. The prices of manufactured products did not significantly fall, whereas the prices of chemicals and machinery rose.

The fall in prices can be attributed to a number of factors, like the boom in agricultural output, tight monetary policies, the declaration of Emergency, etc.

MONETARY DEVELOPMENTS

The severe inflation which prevailed in the Indian economy in the past was undoubtedly partially caused by extensive expansion of money supply. Thus money supply grew by 11.2% in 1970-71; 13.1% in 1971-72; 15.9% in 1972-73; 15.4% in 1973-74; and by only 6.9% in 1974-75. During 1975-76, the growth in money supply is estimated to be around 7.5% which is only slightly more than in the previous year but substantially less than during the earlier years.

The Government continued its tight money policy which was also responsible for controlling inflationary pressures. The availability of credit was severely controlled, interest rates were kept at high levels and monetary discipline was enforced leading to price stabilisation during the past year. In the context of the excellent agricultural output, there has been some selective credit liberalisation but the Governmeent continued to use monetary policy to prevent any increases in the price level.

BALANCE OF PAYMENTS

Although India's external reserves came under pressure in the early months of 1975-76, they improved considerably in the subsequent months. Thus, the total reserves were as follows: they were Rs. 969.2 crores at the end of 1974-75 and Rs. 1,159.1 crores at the end of December 1975 and they had risen to Rs. 1,700 crores by the end of February 1976.

The link with the sterling was broken on 25th September 1975 and had a beneficial effect on the international standing of the Rupee thereafter.

The country's imports have been steadily rising as follows: they amounted to Rs. 1,824.5 crores in 1971-72; Rs. 1,867.4 crores in 1972-73; Rs. 2,955.4 crores in 1973-74 and Rs. 4,468.1 crores in 1974-75. In the first nine months of 1975-76, they were Rs. 3,803.3 crores. On the other hand, total exports have also been rising. They amounted to Rs. 1,970.8 crores in 1972-73; Rs. 2,523.4 crores in 1973-74; Rs. 3,304.1 crores in 1974-75 and in the first nine months of 1975-76 they were Rs. 2,689.5 crores.

As a result of substantial export promotion effort, it is expected that exports would cross Rs. 4,500 crores per year soon and the Government has pledged to make export promotion during the coming years a major part of its strategy for growth.

The comfortable position of Indian foreign exchange reserves should enable the Government considerable flexibility in respect of import licencing in the coming year so as to allow the import of all essential items required for the resumption of growth in the Indian economy.

BUDGETARY APPROACH

The Finance Minister said in his Budget speech "the main thrust in this Budget is thus towards accelerated growth. But consideration of stability will continue to be important." He stressed that the strategy of development by the Government continued to pursue all the goals which had been laid down in the past which were once again emphasised. These goals are a sustained attack on rural poverty, the maximum utilisation of local resources, making full use of the potential offered by modern science and technology for the regeneration of our rural economy and providing productive employment for our work force.

BUDGETARY POSITION

The Budget for 1975-76 had provided for an overall deficit of Rs. 247 crores. The revised estimates have put the deficit at Rs. 490 crores. The increased deficit has occurred despite tremendous buoyancy in revenues from all taxes which exceeded the original Budget estimates by Rs. 660 crores of which the States' share will be Rs. 226 crores. The receipts from market loans exceeded the Budget estimate by Rs. 168 crores and external assistance is expected to exceed the Budget estimates by Rs. 554 crores.

Despite these favourable factors, the large deficit was caused by substantial increases in expenditure in various trends as explained by the Finance Minister in his Budget speech. The expenditure on export promotion exceeded the estimates for 1975-76 by Rs. 71 crores, non-plan budgetary support for public sector units exceeded the estimates by Rs. 210 crores, there was an investment of Rs. 130 crores of Food Corporation of India which was not provided for in the Budget, fertiliser subsidy required Rs. 173 crores more than the estimates, defence expenditure exceeded the original estimates by Rs. 136

crores; a budgetary provision of Rs. 270 crores in excess of the estimates had to be made for various sectors of the Central Plan and Central assistance to State and Union territories Plan went up by Rs. 198 crores over the estimates.

Certain salient features of the next year's Budget may also be highlighted. Tax revenue is expected to rise to Rs. 7,837 crores which represents an increase of Rs. 367 crores over the previous year's figure. Market loans in the coming year are estimated to yield Rs. 535 crores against last year's Rs. 453 crores and external assistance in the coming year is estimated at Rs. 1,341 crores.

PLAN OUTLAY

The most remarkable feature of 1976-77 Budget is that the Finance Minister has provided for a Plan Outlay totalling Rs. 7,852 crores which represents an increase of 31.6% over the allocations for 1975-76. The Finance Minister has correctly said that "this marks the highest step-up in development outlays in any one year since the beginning of the era of planning in our country."

Certain important or major allocations in the plan outlay for 1976-77 should be noted. The plan allocation for development of science and technology is to be stepped up at Rs. 156 crores from the previous year's expenditure of Rs. 116 crores. The Government also proposes to introduce a research and development cess payable by industry in order to increase the outlays on science and technology in the coming years.

The Plan Outlay on agriculture and allied programmes is budgeted at Rs. 323 crores by the Central Government plus Rs. 473 crores by the State Governments.

The Central Government is to spend Rs. 20 crores and the State Governments Rs. 673 crores for flood control and irrigation schemes. This is expected to bring one million additional hectares of land under irrigation.

There is to be a massive increase in the outlays on power development. The outlay on power of the Central Government is estimated at Rs. 129 crores and the States' outlay will amount to Rs. 1,290 crores. The target for additional power generation is put at 2,500 MW against 1,800 MW in the past year. This should result in a massive increase in the demand for industries supplying equipment for power generation and distribution.

The Plan Outlays on petroleum and petro-chemicals are to be increased to Rs. 485 crores compared with Rs. 368 crores in 1975-76. The Government is laying considerable stress on the development of indigenous crude oil supplies which will form a key element in its strategy for growth in the coming years.

The outlay on coal is to be stepped up to Rs. 277 crores resulting in an increase in coal production to 108 million tons in 1976-77. The outlay on fertiliser projects is estimated at Rs. 434 crores against last year's figures of Rs. 290 crores. The outlay on the steel sector is to be doubled to Rs. 402 crores. The Plan provides for an outlay of Rs. 597 crores for transport and communication in 1976-77.

Besides these massive investments, the Plan provides for further investments in the Hindustan Paper Corporation amounting to Rs. 36 crores and in the Cement Corporation of Rs. 20 crores.

These massive investments should result in a substantial increase in the demand for capital goods as well as all other types of products required by the various sectors mentioned above.

BUDGET PROPOSALS

The Finance Minister has proposed in the Budget for 1976-77 that the customs duties be raised to yield an additional revenue of Rs. 38.70 crores. Adjustments in the excise duties are estimated to yield an additional revenue of Rs. 15.12 crores. Thus the total yield from customs duties and excise duties is estimated at Rs. 53.82 crores, of which the State's share will be Rs. 6.57 crores, leaving the Centre with Rs. 47.25 crores.

He has proposed increases in stamp duties which will yield the Centre Rs. 37 lakhs and the States Rs. 18.44 crores in 1976-77.

Increases in excise duties on medicines and toilet preparations, with alcohol, are estimated to yield Rs. 50 lakhs to the Centre and around Rs. 7 to Rs. 7.5 crores to the States. Thus the toal indirect taxation proposed for the budget 1976-77 is estimated to yield Rs. 48 crores for the Centre and Rs. 32 crores for the States.

Since there are no increases in direct taxation the budget imposes a total burden of taxation of only Rs. 80 crores which is an extremely small figure and cannot possibly be considered inflationary in the context of an economy reviving from recession.

The Finance Minister has done a remarkable feat in proposing the smallest additional tax burden imposed during the recent years of Indian fiscal history together with making provision for the largest Plan Outlay.

In direct taxes, the Finance Minister has proposed drastic cuts in the rates of taxes but he has assumed that the revenue will not fall because he expects better collection and better discipline amongst tax-payers to make up for the reduction in the rates of tax.

CUSTOMS DUTIES

The Finance Minister has proposed increases in customs duties on various items to yield Rs. 53.60 crores. He has also simultaneously cut customs duties on various items resulting in a loss of revenue of Rs. 14.90 crores. The nett additional burden of the budget proposals in respect of customs duties will be Rs. 38.70 crores.

The main increases in the customs duties may be outlined. The import duty on caprolactam and DMT is to be raised from 60% to 100% to yield Rs. 11.35 crores. This will close the gap between the price of imported items and the price of these items manufactured in India and, therefore, should not lead to any inflation.

The import duty on acrylic yarn is to be raised by Rs. 20/- per kg. to yield Rs. 1.50 crores. This will again mop up the excessive profit margins of importers in respect of this item and not cause inflation.

The import duty on alloy steel is to be raised from 30% to 60% and there is to be an increase in the countervailing import duty on iron and steel from 75% to 100% which will altogether yield Rs. 18.40 crores. These duties are justified by the Finance Minister in his budget speech "with a view to encouraging greater production of high carbon and alloy steel within the country and larger use of indigenously produced iron and steel". Hence the inflationary impact of this change should be minimum.

It is proposed to increase import duties on stainless steel sheets from 200% to 300% and on stainless steel plates and strips from 60% to 100% to yield Rs. 10.6 crores. The burden of this change is expected to be borne by the profits of the importers of these items.

The import duties on copper are to be raised to yield Rs. 6.65 crores. This is justified by the Finance Minister "as there is a wide gap between the international price of copper and the indigenous price" and therefore should not lead to any inflationary pressure.

Finally there is the proposed rationalisation in duties on items covered by GATT which is estimated to yield Rs. 3 crores.

It will be therefore seen that the above mentioned increases in customs and excise duties should not have any inflationary repercussions.

Customs duties have been reduced on a number of items. The import duty on rock phosphate has been abolished at a cost of Rs. 2.40 crores. This should help the phosphatic fertiliser industry by lowering its cost.

The import duty on machinery and equipment for fertilizer and newsprint plant has been reduced from 40% to 30% which will result in a loss in revenue of Rs. 10.75 crores. This should enable new fertiliser and newsprint plants to be set up at lower capital costs than prevailed hitherto.

Various other minor changes in customs duties have been proposed. The significance of these changes is negligible.

EXCISE DUTIES

The Finance Minister has proposed a substantial reshuffling of the excise duties levied on various items. Thus he has proposed increases in excise duties amounting Rs. 65.10 crores whereas various excise duties have been cut resulting in a loss of revenue of Rs. 49.98 crores. Consequently the nett additional yield from excise duties is estimated at Rs. 15.12 crores of which the Centre will get Rs. 8.55 crores and the States will get Rs. 6.57 crores.

The main increases in the excise duties may be first analysed. The excise duties on the cotton textiles have been rationalised and put on an *ad valorem* basis to yield Rs. 4.6 crores. The Finance Minister has proposed that the maximum retail price must be stamped on every meter of cloth in future in order to protect the consumers from profiteering by middlemen or traders. This is a step in the direction of consumers' protection which must be heartily welcomed and should be extended to various other consumer goods.

The excise duties on paper and boards have been put on an *ad valorem* basis to yield an additional revenue of Rs. 13 crores. The excise duties on aerated waters have been sharply raised to yield Rs. 8 crores. The excise duties on cigarettes have been changed so as to give relief on the cheaper brands but increase the burden on expensive brands resulting in an increase in revenue of Rs. 12 crores. The excise duties on paints and varnish have been raised to yield Rs. 4.30 crores. The excise duty on patent and proprietory medicine is to be raised from 7.5% to 12.5% to yield Rs. 18.20 crores. The excise duty on cement is to be slightly changed to yield Rs. 1.25 crores. The excise duty on starch is increased to raise Rs. 2 crores.

It will be seen, therefore, that the increases in excise duties largely fall on items which are either luxury items or which have substantial profits margins from which they could be absorbed.

The approach of the Finance Minister towards reduction in excise duties has been to cut the excise duties on products which were suffering from recession. This is expected to lead to a reduction in prices which would stimulate the demand for these products and help the manufacturing of these products. Some of the main excise duty reductions may be mentioned. The excise duties on caprolactam and DMT have been cut significantly at a cost of Rs. 9.50 crores in the expectation that the prices of these basic raw materials will be lowered to help the synthetic fibres industry which was suffering from recession. The excise duties on plastic have been cut resulting in a deduction in revenue of Rs. 11 crores in order to stimulate the demand for plastic products which had plunged deeply. The excise duties on small refrigerators and industrial airconditioning machinery are to be reduced at a loss in revenue of Rs. 3.60 crores to revive this industry. The excise duty on motor vehicles have been cut substantially involving a revenue loss of Rs. 3.75 crores. This has enabled the manufacturers of motor cars to reduce their prices by an amount actually larger than the cut in the excise duties, amounting to Rs. 4,000 per car which should help the motor vehicle industry to revive from depression.

Similarly, the Finance Minister has reduced the excise duties on soap, detergent, rayon and synthetic yarns, copper, aluminium, small fans, computers, safety razor blades, etc. in an effort to lift these industries from the deep depression to which they had sunk as a result of a steep fall in their demand.

The cuts in excise duties proposed in the budget should lead to lower prices of many items and also revive the demand for them. They should thus help many recession-plagued industries to revive due to a stimulation in the demand for their products.

DIRECT TAXES

The Finance Minister has adopted a refreshing new approach to direct taxation which represents a total break with the policies followed during the last two decades. He has lowered direct taxes clearly stating that "the majority of Indian tax payers would prefer to abide by the law and pay taxes as due, provided the tax burden is reasonable". He has assumed therefore in the budget for 1976-77 that the cuts in the rates of direct taxes will not result in any drop in revenue because they will "evoke better compliance on the part of the assessees".

In explaining his approach to personal taxation, the Finance Minister in his budget speech said that "at existing rates, the combined incidence of income-tax and wealth-tax works out to more than 100 per cent of income at certain levels. The present structure has been found to be unrealistic. These high rates have not led to any significant reduction of inequality of income and wealth. On the contrary, they have resulted in large scale tax evasion, generation of black money and conversion of visible assets to invisible ones. It is essential to remove these distortions in the economy".

The budget for 1976-77, therefore, proposes a dramatic cut in direct personal taxes which the Finance Minister has described as being "in the nature of an experiment". He has expressed his hope that "with better compliance on the part of the assessee and more efficient administration, we can raise more resources."

PERSONAL TAXATION

The Finance Minister has proposed a drastic cut in the rates of personal income tax in all slabs of income tax for the coming year, that is, assessment year 1977-78.

The rates of income tax have been cut varying from 2% to 15% in the various slabs. The maximum rate of income tax has been reduced from 77% to 66% and this will be applicable on the slab of Rs. 1 lakh whereas formerly the maximum rate applied to income over Rs. 70,000. Thus there are tax reductions in respect of personal income tax at all levels of income which should be heartily welcomed.

On the other hand, the Finance Minister has proposed that the compulsory deposit scheme for the income tax payers be extended by another year, that is for 1976-77 and the rates of compulsory deposit will be raised thus: on current income upto Rs. 25,000 the rate will continue to be 4%, the rate on income of Rs. 25,001 to Rs. 70,000 will be raised from 6% to 10% and on over Rs. 70,000 the rate will be increased from 8% to 12%.

This is expected to raise resources to the tune of Rs. 80 crores which will accrue in 1976-77. The Finance Minister has justified the continuation of the compulsory deposit scheme "to raise resources for financing the Plan and also reduce inflationary pressures generated by larger disposable incomes in the hands of income tax assessees".

It may be argued that the Finance Minister has mopped up savings which would have accrued to tax payers as a result of the cuts in direct personal income tax by continuing the compulsory deposit scheme for one year. However, the total burden of income tax and prevailing compulsory deposit for the assessment year 1976-77 is more than the total burden proposed of income tax and compulsory deposit for the assessment year 1977-78 as proposed in the budget. Thus at all levels of income, tax payers should have more money left in their hands after paying their income-tax and the compulsory deposit for the coming year as compared to what they had during the past year.

Under the circumstances, it is somewhat strange to criticise the Finance Minister as has been done by some persons for having extended the compulsory deposit scheme by one year more, considering that the payments into the scheme will be refunded to tax payers in the coming years and really constitute compulsory savings and are not lost in the form of taxes.

Some minor changes in personal taxes proposed in the Budget may also be noted. First, various deductions from taxable income enjoyed by Hindu undivided families have been removed by the Finance Minister. The Finance Minister has correctly said that "the Hindu undivided family is often used as a medium for tax avoidance". Second, the limit for contribution to recognised provident funds has been raised from Rs. 8,000/- to Rs. 10,000/- per year. The limit for artists, etc., to invest the qualifying savings including annuity has been raised from Rs. 25,000 to Rs. 50,000 per year. Donation to Housing Boards, Slum Clearance Boards etc. have been made eligible for tax concessions under Section 80G of the Income Tax Act.

The exemption from capital gains in case of jewelry sold, where the proceeds are reinvested within six months has been removed since jewelry transactions are not considered high on the list of national economic priorities.

WEALTH TAX

In his Budget speech, the Finance Minister said that "the prevailing high rates of wealth tax provided a powerful incentive for undervaluation and widespread evasion of taxes". He has dramatically cut the wealth tax on all slabs of wealth. Thus the rate of wealth tax on the first slab of wealth up to Rs. 5 lakhs has been reduced from 1% to ½%; the rate of wealth tax on the next slab of Rs. 5 lakhs to Rs. 10 lakhs has been reduced from 3% to 1½%; the rate of wealth tax on the next slab of Rs. 10 lakhs to Rs. 15 lakhs has been reduced from 4% to 2% and the rate of wealth tax on the highest slab of Rs. 15 lakhs and over has been reduced from 8% to 2½%.

The penal wealth tax on urban properties has been totally abolished in view of the introduction of urban land ceiling legislation.

These reductions in the wealth tax are to be welcomed in so far as they will now ensure that the maximum burden of income-tax and wealth tax will not exceed 100% in the case of those where the return on wealth tax at the highest slab exceeds 7½% because such a return would be taxed at a rate of 66% now under the income-tax laws. Since the rate of return on wealth should exceed 7½%, the new rates of wealth tax prevents the total confiscation of income at any level. They should act as a strong spur to savings and investments by individuals in the coming years.

Some minor changes proposed by the Finance Minister may also be mentioned. First, houses constructed by employers for employees drawing up to Rs. 10,000 income per year are to be exempted from wealth tax. Second, new houses with a plinth area of upto 80 sq. meters constructed after 1st April 1976 are to be exempted from wealth tax for five years. This should encourage people to build houses for lower income groups. Third, the assets brought into India by non-resident Indians are to be exempted for seven years and investment by non-resident Indians in equity shares of certain priority and export-oriented industries are to be exempted totally from wealth tax. This should encourage non-resident Indians to bring money into India and such a flow should augment the foreign exchange resources of the country.

CORPORATE AND BUSINESS TAXATION

The Finance Minister has proposed a series of special concessions in the field of corporate and business taxation. He has assumed that despite these concessions the revenue from corporate taxation will not decline due to better administration and greater compliance by the assessees. Thus the new approach to direct taxes is continued in the area of corporate and business taxation.

INVESTMENT ALLOWANCE

In the past, the development rebate and thereafter the initial depreciation were given to encourage companies to invest in new plant and machinery. These are now to be replaced by a new scheme of investment allowances proposed in the Budget. The Finance Minister has proposed an investment allowance equal to 25% of the cost of new ships, new aircraft and new plant and machinery installed by the industries covered by the 9th Schedule of the Income-Tax Act, which is now proposed to be enlarged by adding eight additional industries and by small-scale industries after 1st April 1976. In order to get the deduction of investment allowance various conditions have been specified. The main conditions can be outlined here.

First, it is specified that the assessee must create an Investment Allowance Reserve Account which must be debited to its profit and loss account equal to 75% of the investment allowance (with an exception being made for ships in which case 50% of the allowance is to be put to this reserve). Second, the Investment Allowance Reserve Account is for all practical purposes to be frozen for ten years and cannot be utilised for distribution of dividends but must be used for the purposes of business. Third, the ship, aircraft and plant and machinery in respect of which the investment allowance is claimed cannot be sold for a period of eight years after installation. Fourth, the assessee is required to reinvest within a period of ten years from end of the previous year of the initial installation of the new ship, aircraft or plant and machinery the full value of the Investment Allowance Reserve Account by buying another ship, aircraft, plant or machinery. This means that the investment allowance makes it compulsory for an assessee to buy a new ship, aircraft, plant or machinery twice during the period of ten years from the first initial installation of all such items.

The introduction of initial allowance will undoubtedly provide industry with additional resources for modernisation and replacement of their machinery. Although the conditions of the investment allowance are somewhat stringent or restrictive as compared with the conditions which had governed the scheme of development rebate and the scheme of initial depreciation, the present scheme is to be welcomed in so far as it provides a strong incentive for modernisation, replacement and expansion of industry. Moreover, the funds generated by the Investment

Allowance Reserve Account will be available for transfer to general reserves or for distribution of dividends after the period of ten years has elapsed provided the assessee has *again* bought a new ship, aircraft or plant and machinery equal to the amount of investment allowance reserve account. Thus after a period of ten years these funds will be available to shareholders instead of being lost through the payment of higher taxes which would have prevailed without the introduction of such a scheme.

SURCHARGE ABOLISHED

The Finance Minister has proposed that the existing surcharge of 5% of income tax payable by companies will not be payable if they deposit it with the Industrial Development Bank of India for a period of five years. Details of this deposit scheme have not been announced but it would appear that in lieu of paying the surcharge as a tax the amount will be channelised in the Industrial Development Bank of India which will provide finance for long-term expansion of industry and which will refund these deposits after a period of five years. This is, therefore, a clear reduction in the burden of tax on companies even though the benefit of reduction is deferred for a period of five years.

CAPITAL GAINS TAX

Various other minor concessions to the corporate sector may be mentioned. The rates of capital gains tax payable by companies in respect of sale of properties or other assets have been reduced. Thus the rates of capital gains tax on properties have been reduced from 47% to 55%, from 40% to 50% in the case of widely-held companies and closely-held companies respectively and in respect of sale of other assets from 45% to 40% for all companies.

The Finance Minister has provided that the interest tax of 7% will not be payable by banks on long-term, seven years loans taken by companies. This will reduce the burden of this tax which was being passed on by banks to the corporate sector on account of long-term borrowings for modernisation, replacement or expansion.

Interest on foreign loans are to be exempt from tax provided they are paid under contracts approved by the Central Government. This will enable companies to get foreign exchange loans more easily from the world markets for financing their growth.

The taxation on foreign companies has been rationalised and simplified. Thus their income-tax on royalties is to be levied at the flat rate of 40% and their income-tax on lump sum payments is to be levied at the flat rate of 20% in respect of contracts entered into after 1st April 1976 and approved by the Central Government. The income tax on dividends received by foreign companies is to be 25%.

An initial depreciation of 20% is to be given in respect of workers' housing put up for employees with annual income of Rs. 10,000.

Expenses incurred on entertainment are now to be made deductible for computing taxable income again as per limits which have been prescribed for various slabs of profits and will vary from Rs. 5,000 to Rs. 30,000 in case of various assessees.

The list of backward areas has been greatly expanded so that industries will have a larger choice of areas within which to set up new production facilities in order to get the tax concessions applicable to backward areas.

SURTAX

The Finance Minister has proposed that the threshold at which the surtax will be applicable will be raised from 10% of the capital base to 15% thereof. This will involve a substantial reduction in the burden of surtax to the companies to whom this tax applies. The Companies Surtax Act 1964 provides for the levy of surtax on chargeable profits of companies in excess of the statutory deduction. The chargeable profits comprise the profits as computed for the purposes of income-tax reduced by the income-tax payable thereon and reduced by the statutory deduction which was either Rs. 2 lakhs or 10% of the capital of the company whichever is higher. The Finance Minister has proposed that for calculating statutory deduction the rate of return on the capital base be raised from 10% to 15%. However, the computation of the capital base has been changed to exclude debenture and long-term borrowings which had hitherto had been included in the capital base.

Under the present conditions of interest rates, this will not result in any substantial loss whereas the increase in the rate of return on the capital base from 10% to 15% will result in a substantial relief in the surtax payable by the companies because the chargeable profits were raised by the amount of interest paid on debentures and long-term borrowings (which exceeded 10%).

EXCISE DUTY REDUCTION

In his Budget speech, the Finance Minister said that, "it has been decided to introduce a new scheme of excise relief to encourage higher production. The scheme visualises grant of relief in respect of selected commodities to the extent of 25 per cent of duty payable on goods produced in excess of production in a selected base year. Details of the scheme are now being worked out and I expect that it will be introduced for one year in the first instance." This represents one of the most important concessions to the corporate sector in the budget, even though the details of the scheme have not been announced. The proposed scheme should result in a refund amounting to many crores of rupees in respect of excise duties payable by various industries on increased production, will spur production and could provide a very substantial cash flow which would be available for further modernisation and growth for the industrial sector.

Various estimates have been made of the total impact of the concessions announced to the corporate sector in the Budget. It can be stated that if the Indian industry begins to grow rapidly and is not prevented from expanding quickly the tax concessions offered by the Budget could amount to a very large sum indeed. The exact quantum of benefit will depend upon the growth in the industrial production which occurs in the coming years but it must be clearly noted that the Finance Minister has made a substantial start in reducing corporate tax in the present budget.

CONCLUSIONS

The Budget is definitely growth-oriented and given a good monsoon during June to September 1976, it will spur the resumption of growth in the Indian economy. Industrial production should begin to increase and various recession hit industries should revive as a result of various cuts in excise duties which have been analysed earlier, which should stimulate demand for their goods.

Given conditions of price stability and an expanding situation in agriculture and industries, savings and investments should grow. The stock market should begin to boom with the growth of industrial production and the revival of economy. Price stability can be maintained given reasonable monetary and other policies.

The foreign exchange situation is likely to continue to improve and the foreign exchange reserves may grow to levels at which shortages of foreign exchange will cease to be a constraint on industrial production and growth.

FOLLOW-UP MEASURES

The Budget provides the first package of measures designed to lay the foundation for growth in the Indian economy. The effectiveness of these measures can be spurred or improved upon by taking certain follow-up steps in the field of economic and governmental policies.

First, if the monsoon is good, the bank rate should be cut by at least 2 per cent around August or September 1976. The tight money policy which was designed to fight inflationary pressures in the past years should be reviewed and suitably relaxed so as to reflate the economy under the conditions of price stability and spur the growth of industry and agriculture.

Second, all bottlenecks hampering the growth of industry should be removed. Industrial licencing should be streamlined and all worthwhile industrial projects should be cleared swiftly so that the momentum introduced by the Budget and other policies of the Government may not be stifled by the procedural delays hampering the growth of industries.

Third, other governmental measures such as may be necessary from time to time to reflate the economy consistent with price stability should be taken to give the maximum momentum to the Indian economy in the coming year.

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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