THE ECONOMIC IMPLICATIONS OF UNION BUDGET 1977-78

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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 1977-78 was presented by the Finance Minister, Mr. H. M. Patel, in the context of an economy in which the earlier hopes for the resumption of growth after years of stagnation in the Seventies were belied and the Indian economy had slipped back into a recession due to the failure of the monsoon over parts of the country resulting in a set-back in agricultural production.

The presentation of the present budget is memorable in so far as it is the first budget of the new Janata Party which has come into power in the Government of India and as such it was a momentous occasion where for the first time after Independence a new ruling party has emerged in control of the Central Government. The budget should, therefore, be viewed not only in the context of the state of the Indian economy but also in relation to the announced economic policies of the Janata Party.

In its election manifesto, the Janata Party rejected the old Soviet style planning which had been adopted by the Congress Party since 1956 with its emphasis on building up heavy industries. The old policy was rejected because it had failed to provide a high rate of growth in the economy and had failed to solve such fundamental pro-

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blems as extreme poverty, unemployment, etc. The Janata Party proposes to tackle the problems of the Indian economy by a greater emphasis on rural development on the lines of Gandhian ideas, the development of small, cottage and Khadi industries and greater emphasis on decentralisation of the Indian economy. The old emphasis on large-scale industry and heavy industry in the public sector is to be relegated to the background and continued only in so far as it is relevant to spurring rural development which is of fundamental importance in the Janata Party manifesto.

In analysing the budget, it is first essential to paint the broad picture of the Indian economy as it had developed in the past year and which forms the starting point from which the new Government took over from the old one.

NATIONAL INCOME STAGNANT

As a result of the partial failure of the monsoon and the consequent decline in agricultural production, the growth in national product which was witnessed in 1975-76 was reversed. Thus gross national product at 1960-61 prices had risen 5.8% in 1970-71, by 1.2% in 1971-72, actually fallen by 1.1% in 1972-73, risen by 5.4% in 1973-74, risen minutely by 0.3% in 1974-75, jumped by 8.5% in 1975-76 but is estimated to have risen perhaps marginally by between 1½% and 2% in 1976-77.

More disappointing, the *per capita* nett national product at 1960-61 prices fluctuated as follows: it rose by 3.6% in 1970-71, fell by 1.1% in 1971-72, fell by 3.4% in 1972-73, rose by 3.6% in 1973-74, fell by 1.7% in 1974-75, jumped by 6.6% in 1975-76 and is estimated to have hardly risen in 1976-77.

The Finance Minister in his budget speech correctly analysed that "the most fundamental problem of the Indian economy continues to be its inadequate rate of economic growth. In 1976-77, the rate of economic growth was less than 2 per cent. In the seventies thus far, our growth rate has averaged about 3.5 per cent *per annum,* far too short of our Plan targets ..... even after twenty-five years of planning we are unable to sustain an average growth rate of 5 per cent." He, therefore, concluded "clearly, a fresh examination of our planning priorities and techniques is called for."

The Finance Minister also correctly analysed the causes of this dismal situation. He said in his budget speech that "it is a truism that in a country in which agriculture accounts for nearly 50 per cent of the national income, the overall growth rate of the economy is crucially linked to the performance of the agricultural sector. The poor performance of the economy in 1976-77 was largely because of the decline in our agricultural production." The importance of the agriculture in the Indian economy was further emphasised by pointing out that nearly 80 per cent of the people of the country live in rural areas.

AGRICULTURAL PRODUCTION

The failure in the field of agricultural production in 1976-77 is highlighted by the statistics contained in "The Economic Survey" for 1976-77 of the Government of India. It shows that the index of agricultural production rose by 7.3% in 1970-71, fell by 0.4% in 1971-72, fell by 8.0% in 1972-73, rose by 10.7% in 1973-74, fell by 3.5% in 1974-75, jumped dramatically by 15.6% in 1975-76 but is estimated to have fallen by 5% in 1976-77.

The production of foodgrains in the country was 108.42 million tonnes in 1970-71, 105.17 million tonnes in 1971-72, 97.03 million tonnes in 1972-73, 104.66 million tonnes in 1973-74, 99.83 million tonnes in 1974-75, 120.83 million tonnes in 1975-76 and is estimated to have fallen to approximately 111 million tonnes in 1976-77.

The kharif crop of foodgrains in 1976-77 was about 67 million tonnes as against 74 million tonnes in 1975-76. The production of foodgrains in rabi season appears to have been satisfactory. The production of wheat is expected to be close to the level of 1975-76 but the output of other rabi foodgrains is expected to decline.

"The Economic Survey" comments correctly that "the agricultural performance in 1976-77 highlights the fact that apart from the remarkable performance in 1975-76 due to exceptionally favourable weather conditions, the growth rate in agricultural production in the seventies has been lower than in the sixties and there has been a deceleration in the rate of growth of acreage as well as yield." It points out that the agricultural production in 1975-76 was due to exceptionally good weather but sarcastically notes that "meteorological records show that such uniformly well distributed rainfall all over the country has not occurred in the last thirty-five years." It thus concludes that, "Indian agriculture continues to depend on the weather to a large extent and is likely to remain so for quite some time in the future."

"The Economic Survey" and the Finance Minister in his budget speech have stressed the importance of developing Indian agriculture on sound lines. "The Economic Survey" whilst noting that the production of foodgrains may be considered as reasonably satisfactory stressed that the production of commercial crops during 1976-77 was uneven and unsatisfactory. The production of both oilseeds and cotton slumped to such a low point that the Government was forced to import large quantities of oilseeds and cotton for domestic consumption.

The Finance Minister in his budget speech said that "currently, irrigation potential is growing at an annual rate of about 2 million hectares. We have to evolve a plan to be able to double this rate in the next few years. Both major and medium and minor irrigation works must be planned and executed as part of an optimal national strategy for water use. Similarly, there is an urgent need for stepping up investment in such crucial elements of rural infrastructure as roads, markets, and supply of pure drinking water." He stressed that the development of ground water resources and the digging of tube wells must be given the highest priority.

"The Economic Survey" points out that as a result of five successive reductions in the prices of fertilisers, fertiliser consumption started rising from the rabi season of 1975-76. It also points out that the demand for phosphatic fertiliser has started increasing and stressed that finance must be provided to purchase inputs of agriculture by the farmers and Government should help in the marketing of the agricultural products in the overall strategy of development.

"The Economic Survey" stressed that employment generation remains one of the important problems which the nation has to tackle on a priority basis. It comments that the employment problem is "large and growing. There is, therefore, an urgent need for speedy efforts to generate employment in the rural areas .... the measures for rural employment generation should form an integral part of a local development strategy."

The Finance Minister in his budget speech also stressed the importance of making all households in the agricultural sector viable. He commented that, "this will require, simultaneously, plans for development of ancillary activities like poultry and dairy farming, fisheries, farm forestry, etc. .... we must generate large enough employment opportunities in rural areas so as to slow down migration to urban areas." He said that "it is interesting to note that labour input per acre of land in Japan is four times the corresponding level in India. This is an indication of the scope for generating new employment opportunities in the process of modernising our agriculture."

The emphasis of "The Economic Survey" and the Finance Minister's budget speech on the paramount need of rural development conform with the manifesto of the Janata Party and its announced economic policies and priorities. There can be little doubt that the development of countryside must be the first task of the new Government. In this connection it is interesting to note that the Janata strategy of developing viable village communities in the rural areas has been found to be the most successful strategy for development in Asia as shown in a survey published in the "Economist " (of London) entitled "Two Billion People". This survey shows that countries of Asia which have developed at a fast rate are those that first developed their agriculture and thereafter started industrial development.

INDUSTRIAL PRODUCTION

As a result of the record agricultural production in 1975-76, industrial production received a boost in 1976-77.

The index of industrial production rose by 3% in 1970-71, 3.3% in 1971-72, 4% in 1972-73, 2% in 1973-74, 2.8% in 1974-75, 6.1% in 1975-76 and is estimated to have risen by 10% in 1976-77. Commenting on the developments on the industrial front, the Finance Minister said that "judging by the fact that industrial growth rate since 1965 has averaged only 4 per cent as compared with the average annual growth rate of 8 per cent from 1956 to 1964, the decade since 1965 can hardly be described as a decade of progress in industrialisation ...... In 1976-77 industrial growth rate did increase to 10 per cent. However, there is ample evidence to suggest that this was due to a number of fortuitous circumstances so that the favourable results of 1976-77 cannot be taken as indicative of a more cheerful trend."

Certain industries showed substantial growth in output during 1976-77: these were beverages, transport, basic metal industries, electrical machinery, etc. But "The Economic Survey" points out that "the demand for those consumer goods which could reasonably have been expected to find markets in the rural sector of the economy did not increase appreciably." The cotton textile industry continued to remain very sick and depressed. The jute industry was also very troubled though it appeared to have improved slightly as compared to the previous year. Mini steel plants all over the country closed down.

The performance of the public sector commercial undertakings was uneven. "The Economic Survey" notes that "barring a few, the working of most enterprises leaves much to be desired and the return on resources employed far from adequate." Many public sector enterprises made gigantic losses. The National Textile Corporation's loss is estimated to have been Rs. 60 crores in 1975-76. Coal

India Ltd. is estimated to have made a loss of Rs. 60 crores in 1974-75 and Rs. 28 crores in 1975-76. The Fertiliser Corporation of India which by any standard should be making a profit actually lost Rs. 24.56 crores in 1975-76. The Minerals and Metals Trading Corporation and the State Trading Corporation which earned profits are reported as per various newspaper reports to be involved in a number of irregularities and scandals. It is, therefore, clear that the Soviet style planning and methods of industrialisation adopted during the previous twentyfive years have only resulted in the setting up of gigantic monopolistic public sector enterprises, many of which are very inefficient, some of which are scandal-ridden and all of which will burden the new Government with a tremendous management task. Hence the Finance Minister announced a new approach towards sick industrial units, which is most refreshing. In view of the unsatisfactory experience of the Government in the running of the National Textile Corporation, the Finance Minister announced that "it might be a good idea, if the managements of more efficient mills were to be prevailed upon to take over, as an act of social responsibility, some of the sick units and nurse them back into sound health under conditions to be laid down by Government." This represents a reversal of past Government's policies under which sick industrial units were acquired by the Government which attempted to run them in public sector without any success whatsoever in industries like textile, engineering, coal, etc.

The Janata Party has realised that the running of the existing public sector represents a gigantic challenge and has correctly decided not to take over any more sick industrial units but to attempt to reconstruct and rehabilitate them by asking efficient managements in private sector to take them over: this budget provides tax concessions for such takeovers.

An interesting new approach to industry in order to make it more competitive has also been announced in the budget. The Finance Minister said that "in order to create greater cost consciousness in Indian industry, it is our intention to introduce, gradually, more competition by way of a more liberal import policy." In the second part of his speech, he said that "in order to introduce a measure of competition, it is proposed to allow the import of certain selected items of capital goods without scrutiny from the indigenous angle." The Government has announced that the imports will be used as a tool to control the price level and to make the Indian industry internationally competitive.

The industrial policy of the Janata Party stressed the development of small-scale cottage, village and khadi industries. "The Economic Survey" commented that "the small-scale sector can play a crucial role in the national economy, particularly in raising the standard of living in the rural and backward areas and bringing about a more equitable distribution of income. The high employment potential of the small-scale sector is borne out by the All-India Report on the Census of Small-Scale Industries which revealed that in 1972 for every Rs. 1 lakh of investment in fixed assets, on an average, this sector provided employment to 21 persons. Similarly, the ratio of output to investment in fixed assets was found to be more than double that in the large-scale sector. Thus, both in terms of employment and output, the small-scale sector seems to have a much higher potential compared to the large-scale sector. It will also make possible greater decentralisation of economic power and maximise individual initiative and popular participation in development. It is, therefore, necessary to provide all possible help to accelerate the growth of the sector." It also noted that the small-scale sector was in a grip of very deep recession and that "its overall rate of capacity utilisation was found by the Census to be only of the order of 50 per cent." This highlights the fact that the small-scale industry sector has been the worst hit by the recent economic recession and is in urgent need of encouragement and revival.

The Finance Minister in the first part of his budget speech also stressed the importance of small-scale industrial sector and said that "it should also enable us to make a significant dent in the problem of unemployment." He stressed the need to develop the small-scale sector on the highest priority basis. Unfortunately, the budget does not contain any significant changes in direct taxation which could spur the growth of small-scale industry and it is to be hoped that this task will be attempted in subsequent budgets.

EMPLOYMENT

The most depressing aspect of the Indian economy was the continued stagnation in the employment picture and the dramatic rise in unemployment which continued throughout 1976-77. Employment in the public sector at the end of March each year 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, 128.89 lakhs in 1975 and 133.18 lakhs in 1976. However, these figures have to be viewed in the context of some transfer of private industrial units to the public sector which has taken place over the years and which has swelled the figures of employment in the public sector. Employment in the private sector between 1970 and 1976 has stagnated around 67 to 68 lakhs of persons.

The acute problem of unemployment is highlighted by "The Economic Survey" stating that "the number of job seekers on the live register of employment exchanges in the country as at the end of December 1976 was around 9.77 million as against 9.33 million at the end of December 1975 ..... the total number of educated unemployed rose from 48.05 lakhs to 51.05 lakhs." "The Economic Survey" concluded that "these figures do not give any idea of the extent of unemployment and under-employment in the rural areas. Such indicators as are available point to a large magnitude which continues to grow from year to year. Much, therefore, needs to be done if the rate of growth of employment is to be accelerated not only for absorbing new entrants into the labour force, but also for reducing the backlog of earlier unemployment."

SAVINGS AND INVESTMENT

"The Economic Survey" points out that "provisional data available from the Central Statistical Organisation show that gross domestic savings expressed as a percentage of gross national product (at market prices) went up from 17.5 per cent in 1974-75 to 19.4 per cent in 1975-76. Available data on indicators ..... all point to the rate of domestic savings in 1976-77 being of the same order as in 1975-76. The C.S.O's estimates also show ..... that gross domestic capital formation as a proportion of gross national product increased from 19.1 per cent in 1974-75 to 20.8 per cent in 1975-76 ..... and it appears likely that investment as a proportion of gnp in 1976-77 will turn out to be the same as in 1975-76."

Commenting on this situation, the Finance Minister in his budget speech said that, "other countries which have achieved high rates of growth have been able to invest as much as 30 per cent of national income because of their high volume of savings. The Indian experience has been otherwise. Voluntary savings have been inadequate. Attempts to push up the rate of domestic savings through created money and deficit financing have accentuated inflationary pressures and have not succeeded in raising the savings rate. Thus, some fresh thinking is necessary . . . . ."

The capital market revived slightly in 1976-77. "The Financial Express" equity index which stood at 219, after the presentation of the budget of 1976-77, stood at 242 just before the recent budget was presented. This slight revival in the share markets is probably due to the increase in industrial production which is estimated to have occurred in 1976-77 resulting in higher industrial profits and better performance of some industrial units whose shares are quoted on the stock exchange. It may also be due to somewhat rosy expectations about the budget of the Janata Party and the anticipated success of its industrial and other economic policies.

Other indicators of investment intentions like the assistance sanctioned by the term loan financing institutions, the imports of capital goods, fresh capital raised by the companies, etc. are confusing and mixed. "The Economic Survey" correctly concluded that, "while some increase in industrial investment, undoubtedly, took place, the kind of upsurge hoped for did not materialise for several reasons.

Firstly, there was no great revival in construction, including industrial construction. Secondly a large part of the revival seems to be in the form of expansions and additions rather than new projects, because being less resource intensive industrial units can find a part of the necessary resources internally. Thirdly, for the first time a buyers' market seems to have emerged in many products. Therefore, new investment would be undertaken far more cautiously than in the past."

PRICE BEHAVIOUR

"The Economic Survey" noted that "the most important feature of the economic situation in 1976-77 was a reversal of the declining tendency in prices which had begun in September 1974 and continued through the year 1975-76. The Wholesale Price Index (1970-71 = 100) which had declined by 11.6 per cent between September 28, 1974 and March 20, 1976 rose by 11.9 per cent by March 26, 1977. The All-India Industrial Workers' Consumer Price Index (1960 = 100) has also showed a tendency to rise during 1976-77 though the increase was of a smaller magnitude. It rose from 286 in March 1976 to 312 in March 1977. This price rise which occurred following the record agricultural production in 1975-76 seemed to be essentially due to the shortfall in the production of a few basic commodities."

In his budget speech, the Finance Minister mentioned that "rising prices have further accentuated the hardships faced by the common man. As the House knows, the wholesale price index went up by nearly 12 per cent in 1976-77. This was due, in a large measure, to an excessive increase in money supply last year, the lagged effects of which are still operating in the economy."

Food items and industrial raw materials contributed mainly to the price rise in the first half of 1976-77. The failure of the monsoon pushed up the prices of commercial crops like cotton and oil seeds. However, the buffer stocks of foodgrains held by the Government through the Food Corporation of India and other agencies, at the nd of March 1977 were as high as 18 million tonnes. It is a measure of the acute poverty of the country, the inadequate growth of purchasing power and the deficiencies in the rate and pattern of development that the output of foodgrains of 121 million tonnes achieved in 1975-76 could not be absorbed within the country. The public sector agencies responsible for storing foodgrains ran into acute storage problems and high storage costs in an effort to preserve buffer stocks. But the buffer stocks give the Government some flexibility in its economic policies and its ability to control the prices of food.

MONETARY POLICY

Money supply with the public rose by 11.2% in 1970-71, 13.1% in 1971-72, 15.9% in 1972-73, 15.4% in 1973-74, 6.9% in 1974-75, 11.3% in 1975-76 and is estimated to have risen by 17.1% in 1976-77.

The dramatic increase in money supply has undoubtedly contributed to the inflationary pressures operating within the country. However, "The Economic Survey" points out that "the most important factor responsible for the higher growth of money supply in 1976-77 was the increase in net foreign exchange assets of the banking sector. They rose by Rs. 1,587 crores till March 25, 1977, compared to an increase of Rs. 708 crores during the corresponding period of 1975-76."

In view of this factor, it is argued later that the Finance Minister could have taken credit of a larger figure than what he did on account of special borrowings from the Reserve Bank of India against drawals of foreign exchange reserves. Such borrowings would have reduced the net foreign exchange assets of the banking sector which are held to be responsible for the inflationary pressures within the economy of the country.

The Reserve Bank of India tried to restrain the increase in prices by adopting a selective tight money policy as in previous years but with only limited success.

FOREIGN TRADE AND BALANCE OF PAYMENTS

The only really rosy aspect of the Indian economy is in the area of its foreign trade and balance of payments. Currently the foreign exchange reserves of the country are at an all-time high level having risen to around Rs. 4,000 crores. However "The Economic Survey" points out that "this result has been achieved partly at the cost of investment for growth." This leads to the inevitable conclusion that large drawals on the foreign exchange reserves should be attempted in the coming year to spur growth.

After many years of running deficits in the balance of trade, India's imports is 1976-77 amounted to Rs. 4,908.2 crores and were slightly lower than its exports which reached a record figure of Rs. 4,980.6 crores. Thus a slight surplus in the balance of trade emerged. The country's imports declined due to reductions in the imports of food and fertilisers. Its exports increased in respect of engineering goods, iron, apparel, etc. "The Economic Survey" points out that "the substantial improvement in the balance of payments during 1975-76 was the outcome of a spurt in net invisible receipts on account of remittances from abroad." These inward remittances were largely made by thousands of Indians working abroad who send monies to support their families in India. "The Economic Survey" points out that "the special schemes introduced by the Government to attract the savings of non-resident Indians do not seem to have contributed greatly to this upsurge in remittance," indicating that the remittances do not constitute "hot" money which may flow out of the country easily.

The experience of getting a rising flow of inward remittances from Indians working abroad indicates that one of the best exports which India can effect is that of human beings. In a situation where unemployment of skilled workers remains very high, thousands of engineers and even doctors remain unemployed and millions of unskilled workers cannot find gainful employment within the country, it makes excellent sense to encourage such people to emigrate to countries like the Gulf areas and elsewhere to seize the jobs available in such countries and earn a livelihood there. Such people who go abroad to earn their livelihood invariably have dependents in India to whom they remit monies from their savings resulting in a healthy foreign reserves situation for our country.

BUDGETARY APPROACH

In outlining his budgetary approach, the Finance Minister said that "the task ahead is to devise an effective strategy for dealing with the problems of inadequate growth, crushing poverty, unemployment, growing regional imbalances and rising prices." But the Finance Minister pleaded that it had not been possible to recast the entire structure of the economy in line with the Janata Party's declared priorities because he did not have the benefit of consultations with the new Planning Commission, he could not consult with the State Governments and induce them to implement the Janata Party programmes because the State Governments were controlled by the Congress Party and it was not possible to suddenly stop the capital expenditure on-going projects which had to be finished. Thus, he had to operate within severe constraints and could not overnight change the old economic policies and priorities of the earlier Government.

BUDGETARY POSITION

At current levels of taxation, the budget for 1977-78 was estimated to have a deficit of Rs. 202 crores. This position was estimated despite buoyancy in revenues from taxation which are estimated at current levels of taxation to yield Rs. 8,879 crores in 1977-78 showing an increase of Rs. 798 crores over the revised estimates for 1976-77. Receipts from all the main heads of tax, viz., excise duties, customs duties, income and corporation taxes are expected to increase substantially in the coming year.

Non-essential expenditure which had been identified is estimated to yield a reduction in expenditure of Rs. 130 crores in 1977-78. Defence expenditure is estimated at Rs. 2,752 crores which is Rs. 56 crores less than the provision made in the interim budget. The budget takes credit for Rs. 130 crores of borrowing from the Reserve Bank of India against rceipts from Compulsory Deposit Schemes for 1977-78. Finally, the Finance Minister has taken credit in the budget for 1977-78 of Rs. 800 crores as special borrowings from the Reserve Bank of India against drawals of foreign exchange reserves. As mentioned earlier, since foreign exchange reserves have been partially blamed as the cause of inflationary pressures within the economy the Finance Minister should have drawn much more than Rs. 800 crores as special borrowings from the Reserve Bank of India against drawals of these reserves. It should have been possible to borrow Rs. 1,200 crores under this head and there should have been no difficulty in spending a figure of Rs. 1,200 crores on imports. If the Finance Minister had provided for special borrowings of Rs. 1,200 crores from the Reserve Bank of India against drawals of foreign exchange, the budgetary deficit of Rs. 202 crores would have been converted into surplus of Rs. 198 crores which could have been used to cut direct and indirect taxes and to increase developmental outlays in the rural areas to spur growth. The Finance Minister has thus missed a unique opportunity of presenting a surplus budget.

The Finance Minister has proposed additional taxation in the budget to yield Rs. 130 crores for 1977-78 and has left an uncovered deficit of Rs. 72 crores. There was absolutely no need to keep such a deficit and the budget could have been turned into a surplus one by availing of an increased figure of special borrowing from the Reserve Bank of India against drawals of foreign exchange. Such action would have curbed inflationary pressures within the economy.

PLAN OUTLAYS

The budget proposes a total outlay on the annual plans of the Centre, States and Union Territories for 1977-78 of Rs. 9,960 crores as against Rs. 7,852 crores in the previous year. This represents an increase of 27 per cent. Even if one makes an adjustment for inflation, the Plan of the coming year will be substantially larger than the Plan for

1976-77 and to that extent should increase investment and growth in the Indian economy.

A careful analysis of the structure of the Plan Outlays shows that the pattern is quite similar to that of the earlier years. This reflects the constraints within which the Finance Minister had to frame the budget and the Plan Outlay, and highlights the fact that he did not have the benefit of the advice of a new Planning Commission nor could he change on-going projects which he had inherited from the previous government. It also highlights the difficulty of shifting gears overnight into a new set of economic priorities. Nevertheless, the Finance Minister has tried to do his best to make such adjustments as were possible within these limitations and has given the Plan a small thrust towards the economic policies of the Janata Party.

In his budget speech, the Finance Minister stated that, "the total Plan Outlay on agriculture and allied services, major, medium and minor irrigation projects and fertilisers, together with provisions for cooperatives and power sectors attributable to rural areas works out to Rs. 3,024 crores ... This constitutes 30.4 per cent of the aggregate outlay of the Central, State and Union Territories Plans."

The comparable figures of outlays on this sector for 1976-77 was put at Rs. 2,312 crores which amounted to 29.4 per cent of last year's Plan outlay. This indicates that there is only a minute relative shift in the plan outlays towards this sector which has been stressed as deserving the highest priority by the Janata Party.

Some other outlays for rural developments may be noted. The Finance Minister has proposed to make a small beginning by providing for an outlay of Rs. 20 crores for developing approach roads to villages. He has proposed an additional outlay of Rs. 40 crores for providing drinking water in the villages. In the budget speech, it was mentioned by the Finance Minister that "it is our belief that Khadi and village industries, if they are property organised and supported, are capable of generating employment on a large scale. A provision of Rs. 35 crores has been made for these programmes in the Plan, with the understanding that more funds will be allocated, if required. It is expected that the schemes in view will provide employment for about 25 lakh persons." An outlay of Rs. 20 crores is provided for handlooms and Rs. 4 crores for agriculture. These outlays should give some fillip to these rural and labour intensive industries.

The total outlay on power will be Rs. 1,935 crores in 1977-78 compared with Rs. 1,419 crores in the previous year. This should give a boost to the generation and transmission of electricity and also speed up rural electrification.

The outlay on petroleum is to be stepped up to Rs. 677 crores in 1977-78 compared with Rs. 485 crores in prev'ous year. It is estimated that indigenous crude oil production will rise to 11.31 million tonnes in 1977-78 as compared with last year's figure of 8.89 million tonnes.

Even after "taking into account the feasibility of rephasing of the expansion programmes of the Bhilai and Bokaro complexes", the Finance Minister had to provide for an outlay of Rs. 511 crores for steel as compared to Rs. 402 crores in the earlier year. The outlay on Hindustan Paper Corporation is to be Rs. 61.41 crores as compared to last year's figure of Rs. 36 crores. The outlay on the Cement Corporation of India is to be Rs. 32.89 crores compared to last year's outlay of Rs. 20 crores. These massive outlays on public sector industries indicate that ongoing projects had to be completed and the Finance Minister did not have any option except to provide for these massive investments in public sector units which had been started by the earlier government. It highlights the difficulties of shifting from the Soviet-style planning approach of the former government with its emphasis on heavy industries to the Janata Party's policies in which such industries would enjoy low priority.

The total outlay on transport and communication is to be Rs. 651 crores. This figure includes Rs. 302 crores for the development of railways. Since last year's outlay on transport and communication was Rs. 597 crores, the plan outlay for the coming year will set the outlay on this sector in real terms, that is adjusted for inflation at roughly the same level.

The major outlays of the plan reveal that the structure of the plan and relative priorities continue on the old basis on account of the constraints faced by the Finance Minister. It is to be hoped that with the help of the new Planning Commission, the entire plan outlays and their relative emphasis will be changed on the lines promised by the Janata Party when the next budget is presented for 1978-79.

BUDGET PROPOSALS

In Part A of his budget speech, the Finance Minister rightly stated that, "high direct tax rates have been found to be counter-productive because of the evasion that ensues and in any case the number of people who fall in the direct tax net is so small that revenue realisation cannot match requirements. Indirect taxation seems also to have reached its limit." Despite this unambiguous statements, the Finance Minister has proposed new direct and indirect taxation in the budget. This highlights the incongruity in the approach of the budget even in relation to statements made by the Finance Minister himself in the first part of his budget speech.

EXCISE DUTIES

The excise duties on a number of items have been raised to yield Rs. 106.3 crores in a full year. On the other hand, the excise duties on various items have been reduced involving a sacrifice of Rs. 15.7 crores. Thus a net yearly increase in the central excise levies is proposed of Rs. 90.6 crores. The budget provides for the transfer of excise duty on woollen yarn and woollen tops to a customs duty on imports, involving a transfer of Rs. 17 crores from Central Excise to the Customs, thus giving a net increase of Rs. 73.6 crores under the Central Excise head. Since the States' share will be Rs. 19.8 crores, the revenue accruing to the Centre from the budget proposals is estimated at Rs. 53.8 crores in a full year.

Some of the main changes in excise duties may be noted. The excise duties on tobacco, cigarettes and bidis have been raised to yield Rs. 45 crores more in a full year. The imposition of excise duties on these items has been aptly termed by the Finance Minister as a "hardy annual" as these items are capable of absorbing such duties almost to an unlimited extent. The excise duties on pigments, paints, enamels and varnishes are proposed to be levied at *ad valorem* rates and increased to yield Rs. 4.8 crores in a year. The excise duty on motor vehicles is to be raised from 15% to 17½% and the rate of duty on two-wheeler and three-wheeler motor vehicles is also proposed to be raised to yield Rs. 5.1 crores annually. The excise duty on cinematograph films is to be levied on an *ad valorem* basis to yield additional revenue of Rs. 7 crores in a year. The excise duty on commodities not otherwise specified is to be raised from 1 per cent to 2 per cent to yield additional revenue of Rs. 30 crores in a full year. Here the Finance Minister has continued a concession given to smaller units which hitherto were defined by the number of workers employed but henceforward are to be defined as those units whose annual turnover does not exceed Rs. 30 lakhs.

New items have been brought within the excise net for the first time to yield total revenue of Rs. 10.75 crores. The items on which excise duty is to be levied for the first time are gases, polishes, watches, weighing machines, electric light fittings, tools, etc.

The excise duties on certain fabrics made in the handloom and powerloom sector are to be abolished involving a revenue loss of Rs. 2.5 crores. Similarly, the excise duty on cotton yarn of higher counts in cross reel hanks is reduced involving a sacrifice of Rs. 1.50 crores. Hand processed fabrics are to get exemption from excise duty involving a sacrifice in revenue of Rs. 75 lakhs. These concessions are in line with the Janata Party's policy of decentralising industries and should be welcome. They will free about 80,000 powerloom licencees from the excise control. The excise duty on crimped yarn is to be reduced from Rs. 10 per kg to Rs. 5 per kg. This will give some relief to the industry which is suffering from a slump. The excise duty on power driven pumps is to be reduced from 10 per cent to 5 per cent and power tillers are to be exempted from the general excise levy.

These concessions are expected to benefit small farmers and help rural development. There are other reductions in the excise duty on paper made by small paper mills and out of un-conventional raw materials, on small-scale units in the match industry and on mini steel plants.

The budget also contains some rationalisation of excise duties. The excise duty on consumer electronic items is to be levied on an *ad valorem* basis instead of on a specific basis. Here again there are some concessions for small-scale manufacture as well as for consumer items of low value. The excise duty levied on the organised cotton textiles industry is to be telescoped on an *ad valorem* basis instead in the present specific basis. A small start is to made in this rationalisation towards a multi-fibre policy by defining fabric containing polyester up to one-sixth of the total fibre content to be classified as cotton fabric.

It will be seen that except for few reductions of excise duties in favour of decentralisation or small-scale sector and the rural sector, the changes in the excise duties proposed by the Finance Minister are largely for the purpose of raising revenue. The extent to which the burden of these excise duties will be passed on to the consumer in cases where the excise duties have been increased will depend upon the profit margins of the manufacturers and to the extent of their being able to absorb the new levy out of their profit margins in the context of market conditions. Their inflationary impact if any will be negligible.

CUSTOMS DUTIES

The Finance Minister announced that in order to smash the smuggling of watches, it is proposed to allow Hindustan Machine Tools Ltd. to import watches and their components on a large scale. The customs duty on watch parts and watches is to be reduced from 120 per cent to 50 per cent *ad valorem*. This is estimated to yield Rs. 12 crores in a year.

The most dramatic cuts in import duties are proposed to respect of alloy steel and high carbon steel on which the import duties are to be brought down from 75 per cent to 40 per cent and in the case of stainless steel plates, sheets and strips where customs duties will be drastically cut from a range of 120 per cent to 320 per cent to a new proposed range of 40 per cent to 120 per cent. This dramatic cut in import duties on alloy steels and stainless steel is welcome and should reduce the prices of these essential raw materials. They will involve a loss in revenue of Rs. 25.45 crores.

The import duty on copper wire bars is also to be slashed at a cost of Rs. 11.80 crores. The import duty on newsprint is to be reduced from 5 per cent to 2½ per cent, which will involve a loss of Rs. 1.40 crores. The total reductions in customs duties come to Rs. 37.65 crores in a full year. These reductions are steps in the right direction because they involve reduction in rates of import duties on items of which the domestic prices are excessively high and for which the consumer had to pay astronomical prices. They will reduce prices and be anti-inflationary.

Taking all the proposed changes in union excise duties and customs duties, the net yield for the Centre in a full year is estimated to be Rs. 48.6 crores but the yield during 1977-78 is estimated to be Rs. 32.8 crores.

PERSONAL TAXATION — INCOME TAX

The budget provides that no income tax shall be payable by individuals and Hindu Undivided Families whose taxable income does not exceed Rs. 10,000 in a year. Thus the Finance Minister has implemented the promise given in this respect in the Janata Party's election manifesto. It is estimated that as a result of this change approximately 8.2 lakhs assessees will be removed from the income tax net out of a total number of 38 lakhs assessees. The raising of the exemption limit of income is welcome and is a step in the right direction. It will also simplify the working and administration of the income tax department by removing lakhs of small cases and allow the department to handle more efficiently the cases involving larger incomes.

Unfortunately in order to minimise the loss in revenue, the Finance Minister has provided that where the income of individuals or Hindu Undivided Families exceeds Rs. 10,000, the slabs of income tax will start at Rs. 8,000. But some marginal relief will be given to those whose total income amounts to slightly over Rs. 10,000. It is difficult to justify this peculiar structure of income tax slabs which will only cause further administrative complexities and puzzle many assessees.

The Finance Minister has proposed a substantial increase in the burden of income tax payable by individuals and Hindu Undivided Families by increasing the surcharge on income tax in the case of all categories of tax payers except companies from 10 per cent to 15 per cent. As a result of this change the maximum marginal rate of income tax will rise from 66 per cent to 69 per cent. It is estimated that the proposed changes in personal income tax will yield an additional revenue of Rs. 23.20 crores in 1977-78.

Moreover, the Finance Minister has proposed that the Compulsory Deposit Scheme for income tax payers is to be continued for another two years. He has justified this by saying that it is necessary in view of "the state of economy and inflationary pressure that exists." The result of the increase in the surcharge on income tax and the continuation of Compulsory Deposit Scheme is that their maximum marginal burden will be 81 per cent of the income of assessees in the highest tax brackets. This will result in a drain on private savings and reduce private investment.

WEALTH TAX

The budget proposes an increase in the wealth tax with retrospective effect. It is proposed to increase the rate of wealth tax by ½ per cent for slabs of Rs. 2½ lakhs upto Rs. 15 lakhs and by 1 per cent on the slab of over Rs. 15 lakhs of net wealth to yield Rs. 10 crores in 1977-78. It has been a tradition of many years to make changes in direct taxation prospective. Unfortunately the Finance Minister has broken this tradition and has provided that the increased rate of wealth tax will apply for the financial year 1976-77 or the assessment year 1977-78. No justification whatsoever is given for this inequitable retrospective effect of these changes except the revenue yield.

The combined burden of income tax including the surcharge at the new proposed increased rates, the wealth tax at the new increased rates and the Compulsory Deposit Scheme may exceed in some cases 100 per cent of the total income of an assessee. It is ironical that such a burden is proposed by the present Finance Minister who in the first part of his budget speech had pointed that "high direct tax rates have been found to be counter-productive because of the evasion that ensues."

TAXATION OF CAPITAL GAINS

The Finance Minister in his budget speech stated that "the present structure of capital gains taxation stands in the way of adequate mobility of investible resources and perpetuates investment in low priority assets ..... moreover, capital gains arising from the transfer of assets held over a length of time is in a world of rapid and continuing inflation to a great extent illusory in nature." He has, therefore, proposed important changes in the taxation of capital gains.

First, capital gains arising from the transfer of a capital asset held for a period exceeding 60 months were entitled to the concessional tax treatment and classified as long-term capital gains. With a view to improving mobility the Finance Minister has proposed to reduce the holding period to 36 months. This will definitely improve the mobility of assets and enable investors in various assets to sell them and to vary their investments without being locked into them for a period of five years.

Second, in respect of capital assets acquired before 1st January 1954, the taxpayer had the option of adopting the fair market value of the asset on 1st January 1954 in place of the actual cost of acquisition for computing long-term capital gains. The Finance Minister has now advanced this date by 10 years, that is, he has substituted 1st January 1964 in place of earlier date. This will mean that capital gains which occurred between 1st January 1954 and 1st January 1964 will not be subject to capital gains taxation. While welcoming this step which recognises the illusory nature of capital gains, as admitted by the Finance Minister, it is suggested that even the new proposed date of 1st January 1964 is too far distant. In the next budget the Finance Minister should bring the date forward to say 1st January 1970.

Third, it is proposed to totally exempt an assessee from taxation of long-term capital gains if the sale proceeds of any asset are reinvested within six months in shares listed on the stock exchanges, three year bank deposits, units of Unit Trust of India, Government Securities of Central and State Governments, Government Savings Certificates, or debentures issued by the cooperative societies, etc, and approved by the Central Government. This exemption from the taxation of long-term capital gains if the sale proceeds of any assets are reinvested within six months is an excellent step towards diverting investible resources into priority channels of investment whilst simultaneously encouraging mobility of assets. However, to ensure that this concession is not abused, the Finance Minister has provided that the new investment in approved assets must be held for a period of not less than 36 months.

These changes in the taxation of capital gains should improve the liquidity position of many assessees, encourage them to sell off non-productive assets like jewellery, landed property, etc. and direct the flow of private savings into the approved investments as laid down by the Finance Minister. However, the short-term effect of this concession may be a drop in the prices of shares because many investors who have made long-term capital gains which were subject to tax over the past twenty years will be tempted to book these capital gains now that they are exempt from tax and they may reinvest the sale proceeds in approved investments other than shares if they are unable to discover attractive investment opportunities in the immediate future in the share market. But this can be only a temporary phase and once the burden of sales of scrips or shares made by investors to take advantage of this new concession is absorbed by the stock markets, there should be a revival in the stock markets if the monsoon is good and the economy begins to pick up as a result of the new Government's policies.

CORPORATE OR BUSINESS TAXATION

The Finance Minister has increased the burden of direct taxation on corporate sector by providing that companies will have to pay 5 per cent surcharge on income tax and will not be able to avoid the surcharge by making deposits of an equivalent amount with the Industrial Development Bank of India for a period of five years as was permitted by the previous budget. This burden of tax on the corporate sector will amount to Rs. 56 crores in the coming year. This change will not immediately affect the cash flow of the corporate sector except to the extent that after a period of five years they will not get a refund of any deposit made with Industrial Development Bank of India but will lose the amount of surcharge as a direct tax. No justification whatsoever is given for this change except that it is a revenue measure.

INVESTMENT ALLOWANCE

The previous budget (for the year 1976-77) introduced the investment allowance. The deduction on account of investment allowance was given in the computation of taxable profits at the rate of 25% of the cost of new ships, new aircraft and new plant or machinery installed by those engaged in shipping, operation of aircraft, generation or distribution of electricity, manufacture of priority items in the Ninth Schedule of Income Tax Act and to all small-scale industries. The Finance Minister has proposed to extend the scope of the investment allowance to all industries excluding only certain industries which in his opinion should enjoy low priority and are listed in a new Eleventh Schedule proposed to be inserted in the Income Tax Act. The extension of investment allowance to a larger number of industries is welcome. However, the Finance Minister has unwittingly withdrawn the investment allowance from thousands of small-scale industries because he has excluded from the purview of the allowance small-scale industries manufacturing items contained in Eleventh Schedule, whereas hitherto all existing small-scale industries were entitled to the benefits of the investment allowance. It is likely that this withdrawal of investment allowance from small-scale industries manufacturing items in the Eleventh Schedule like toothpowder, soap, gramophone, tape recorders, radios, household furniture, utensils, cosmetics, toiletries, confectionery, chocolates, etc. may be a result of the clumsy drafting of the section and it is to be hoped that the Finance Minister will rectify this by amending the Finance Bill to provide that all small-scale industries will continue to get the benefit of the investment allowance.

The budget also provides for a grant of investment allowance at a higher rate of 35 per cent on new plant and machinery installed for the manufacture of articles made in accordance with know-how developed in government laboratories, public sector companies or universities. Whilst the emphasis on use of indigenous know-how is welcome, it is difficult to understand why this concession should not be available in respect of manufacturing activity done with the use of indigenous know-how developed in the private sector. It should be extended substantially to include all manufacturing activity in which foreign know-how is not involved.

SICK UNITS

In his budget speech, the Finance Minister stated that, "sickness among industrial undertakings is a matter of grave national concern. Closure of any sizeable manufacturing unit in any industry entails social costs in terms of loss of production and employment, and also waste of valuable capital assets. Experience has shown that taking over of such units by Government is not always the most satisfactory or the most economical solution. A more effective course would be to facilitate voluntary amalgamation of sick industrial units with sound ones by providing certain incentives and by removing impediments in the way of such amalgamation." The budget provides that where a sick industrial company is amalgamated with a healthy one, the accumulated losses and unabsorbed depreciation of the sick company will be allowed to be carried forward and set off in the income tax assessment of the healthy company into which it amalgamates. However, the Finance Bill lays down a series of onerous conditions, which have to be fulfilled to get the benefit of this tax concession. Thus it is provided that the sick company should have lost 50 per cent of its capital and reserves, the sick company must be proved to be not financially viable, the amalgamation has to be proved to be in the public interest and the consent of the Central Government or a specified authority appointed by the Central Government to the terms of the amalgamation must be secured. It is to be hoped that the Government of India will facilitate the rationalisation and revitalisation of sick units by making the new provision in the budget for giving the unabsorbed losses and depreciation of sick units to healthy units into which they amalgamate effective by setting up efficient administrative procedures and appointing competent personnel to give clearance for such mergers within maximum stipulated time of 60 or 90 days after applications are lodged with the Government for such mergers.

RURAL DEVELOPMENT

The budget provides that the companies which incur expenditure by undertaking work of rural welfare and uplift after 30th June 1977 will be allowed a deduction of such expenditure for computing taxable profits. Here again it is laid down that the tax concession will be available only after the programme of rural development undertaken by the company is first approved by the prescribed authority to be set up by the Government of India. If this administrative provision is worked expeditiously and effectively, the new concession contained in the budget could yield many crores of rupees for rural development. Enlightened companies should make substantial contributions to this cause. No limit is placed on the expenditure which a company can incur on rural welfare and uplift and it is to be hoped that profitable companies will make generous contributions to this very worthwhile cause.

The budget proposes that new small-scale undertakings set up in rural areas after 30th June 1977 will be entitled a deduction of 20 per cent of their profits for computing their taxable profits for a period of 10 years from the date of their starting production. While this concession is welcome, it may be argued that in the present state of economy it is doubtful if a mere tax concession for new small-scale industrial units set up in the rural areas will really spur the growth of such units. The small-scale industrial sector is in the grip of one of the worst recessions and as noted in "The Economic Survey" it is running at 50 per cent of its installed capacity. Thus when thousands of existing small-scale units are losing money or are on the verge of closure, it is doubtful whether new small-scale industrial units will be set up in rural areas which lack the essential infra-structure needed by small-scale industrial units. The need of the hour is to extend such a tax concession to all existing small-scale industries for a period of ten years commencing from 1st April 1978 and then to provide for a further incentive for new small-scale industrial units set up in rural areas.

MINOR CHANGES

The budget contains a number of minor changes in direct taxation. Some of the more important ones may be mentioned here. The ceiling limit of donations to charitable trusts and institutions has been raised from Rs. 2 lakhs to Rs. 5 lakhs. This is a step which is to be heartily welcomed.

Charitable trusts are given up to 1st April 1981 to dispose of their non-approved assets like shares instead of the time limit of 1st April 1978. This will mitigate hardships on charity trusts which were trying to conform with the provision of the law but faced various obstacles in reshuffling their investments within the old time limit.

Closely held industrial companies are to be exempt from compulsory distribution of dividends. This will enable such companies to plough back their profits into the business and lead to increased corporate savings and investment in the coming years.

The budget provides that the companies may not deduct income tax at source in respect of dividends of Rs. 250

or less. But onerous and impractical conditions have been attached to this provision. Thus it is required that the shareholder wanting to take advantage of this provision will have to produce a certificate verified by the income tax authorities that his total income for the particular assessment year will not exceed the limit of income exempt from tax. It is difficult to see how in the middle of an assessment year such a certificate can be produced because it may be impossible for a small shareholder to estimate the income which he will get in the remaining part of the year. Hence the provision for producing such a certificate will largely nullify the relief sought to be given by the budget provision. If the Finance Minister wants to help and encourage small shareholders, it should be provided that any dividend payment of Rs. 250 or less should not be subject to deduction of income tax at source.

CONCLUSION

The Finance Minister has admitted in Parliament recently that on account of various constraints which faced him he could not present a budget which was completely on the lines promised in respect of economic policies and priorities by the Janata Party in its manifesto. The budget has continued planning on the same basis as in the past but the increase in the size of the plan should involve a step-up in investment in the Indian economy. The increase in the burden of direct taxation on individuals and companies is not justified in the context of an economy groaning under the weight of the worst recession seen in the recent years. Direct taxes should have been cut to stimulate economic growth.

The changes in the taxation of long-term capital gains may initially depress the stock market but over a longer period they should lead to greater mobility of assets and increase the attractiveness of investment in shares. The monsoon and its effect on the Indian economy will determine the level of share prices after an initial period of adjustment to the new changes in the taxation of capital gains has taken place in the stock markets.

The emphasis on the rural development and the development of small-scale industries should be increased dramatically in the coming years. The budget fails to provide a single concession in direct taxation to existing small-scale industrial undertakings and even withdraws the benefit of investment allowance from some small-scale industrial undertakings. It is to be hoped that the Finance Minister in the next budget will introduce a series of direct tax concessions for small-scale industries, largely by putting them on a preferential footing compared with large-scale industries which have enjoyed preferential direct tax advantages for more than twenty five years.

The Finance Minister is to be congratulated for having done a good job in the context of the various constraints within which he had to work in framing the budget.

The views expressed in this booklet are not necessarily the views of the Forum of Free Enterprise.

(Since this talk was given, the Finance Minister has modified some of the budget proposals.)

"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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