THE UNION BUDGET - 1969-70

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FORUM OF FREE ENTERPRISE
SOHRAB HOUSE, 235 DR. D. N. ROAD, BOMBAY-1

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"People must come to accept private enterprise not as a necessary evil, but as an affirmative good."

—Eugene Black

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by

N. A. Palkhivala *

In one of his short stories, Somerset Maugham deals with the difficulty of characterising human nature and conduct as either white or black. He points out that when judging human action one has often to ask the question whether it is a good man doing a bad deed or whether it is a bad man doing a good deed. A somewhat similar question arises with respect to this year's Budget. Is it a good Budget with some bad features or is it a bad Budget with some good features?

A few basic points about the Budget may be noted:

(i) There is no increase in Corporate taxation.

(ii) In the field of personal taxation, there is just a small increase amounting at the outside to Rs. 275 in the tax burden on the income slab between Rs. 10,000 and Rs. 20,000.

(iii) Except as regards provisions dealing with advance payment of tax, there are no significant changes proposed by the Finance Bill in the Income-tax Act. That evil deed—a massive dose of amendments—is left to be done later by another Bill which the Finance Ministry has threatened to introduce in this Session of Parliament.

(iv) The confusion in the fiscal laws became worse confounded when the Finance Acts of 1967 and 1968

* Mr. Palkhivala, President of Forum of Free Enterprise, is an eminent authority on taxation. This text is based on a public lecture delivered under the auspices of the Forum in Bombay on March 3, 1969. Some of Mr. Palkhivala's writings on taxation, published by the Forum over the years, have been incorporated in a book, **"Taxation in India—9 Commentary"** (Published by Popular Prakashan, 35-C, Tardeo Road, Bombay 34), and is available to Forum members and student associates at a concessional price.

had two sets of amendments, one for the relevant assessment year and one for the next assessment year. This practice, very fortunately, has not been followed in this year's Finance Bill.

(v) The great economic achievement of the current year has been the maintenance of the price level. The Wholesale Price Index of all commodities is about 205 as compared to the Index of about 208 a year ago (taking 100 as the base in 1952-53). This year's Budget with its proposed modest deficit of Rs. 250 crores is not likely to increase inflationary pressures, nor will it affect the economic environment adversely in any manner.

(vi) As usual, the Budget Speech of the Finance Minister is more stimulating than the Budget proposals. The speech has been couched in a lighter vein, though most untaught citizens would have preferred lighter taxes.

The unfortunate fact is that the Budget will not stimulate the economy and will not be the precursor of an economic boom as the first Budget of the Fourth Plan should have been.

The total tax revenues proposed to be raised in the next year will aggregate to Rs. 2,715 crores, of which about Rs. 1,500 crores, i.e. 55% of the total Central tax revenues, will be represented by excise. An additional excise levy of Rs. 27 crores has fallen on sugar, Rs. 24 crores on fertilisers and power-driven pumps, and Rs. 14 crores on motor spirit.

Cigarettes will bear an additional excise duty of Rs. 16 crores. It was Napoleon who said that vices are good patriots. The love of brandy brought him 5 million francs; and he wanted to know which virtue contributed so generously to the Public Exchequer! Emerson endorsed this dictum and added that vices have broad backs and tobacco would cheerfully carry the load of armies. The Finance Minister's Budget Speech indicates that the levies on tobacco and motor spirit have been so raised as to avoid the necessity of further increases in the excise on those commodities in future years. But it is extremely doubtful whether the temptation to increase the levy still further on these goods will be resisted in the years ahead.

The lowering of the export duty on hessian and tea and on certain varieties of cotton textiles was badly needed. However, the reduction is perhaps less than the bare minimum dictated by the exigencies of the situation.

The increase in duty on motor spirit by 7 paise per litre will push up the cost of motor transport still further. The automobile industry is more heavily taxed in India than anywhere else in the world. 44% of the total capital cost of commercial vehicles is represented by taxes. 56% of their basic operational cost is again the tax component. 15% of the entire tax revenues of the Centre and all the States comes from the automobile industry. The cumulative tax per tonne-mile imposed on commercial motor transport is equal to the total freight charged by the railways per tonne-mile. Throughout its life, the commercial vehicle is a richer source of revenue to the Central and State Governments than it is to its owner, and yet this year the burden on commercial vehicles will be unfairly enhanced still further as a result of the increased levy proposed by the Budget.

A budget should be moulded by the needs of a nation, containing within it the seeds of economic growth. But unfortunately, our Budget is the prisoner of (a) the unapproachability of the agricultural sector, (b) the inefficiency of the Public Sector undertakings, (c) the irrepressibility of the Central Government's expenditure and (d) the indiscipline of the State Governments.

(a) Strange as it may seem, it was a pure historical accident which resulted in agricultural income being outside the purview of taxation by the Centre. Income-tax was first levied in India by James Wilson, the Member for Finance, who published his Budget Estimates on the 18th February 1860. The first levy of income-tax in that year embraced agricultural income also. When tax on non-agricultural income was replaced by a licence tax, agricultural income was assessed to a corresponding burden in the shape of a cess. It was the continuing existence of this cess that was responsible for the exemption of agricultural income in the Income-tax Act of 1886 which reimposed income-tax after its earlier repeal. The burden of the cess on agricultural income has since been removed, but the anomaly of exempting agricultural income has continued.

During the last 21 years, there have been two tremendous redistributions of wealth and shifts of capital and income—the liquidation of the ruling princes and jagirdars in the first years of Independence and now the colossal shift in terms of trade in favour of agriculture.

The total national income of India is about Rs. 29,000 crores, of which half the income is agricultural. On a total agricultural income of Rs. 14,500 crores, the aggregate of agricultural income taxes collected by the States is only Rs. 11 crores, while Rs. 109 crores is collected as land revenue. In glaring contrast, the total burden of income-tax on non-agricultural income of the same amount is Rs. 688 crores, over and above the land revenue which is payable on non-agricultural lands, and the burden of wealth-tax which is Rs. 12 crores.

Big farmers who own 65% of the land have a total income of Rs. 6,000 crores. An agricultural income-tax on them even at the low rate of 5% would yield Rs. 300 crores.

In Parliament today, where all too often "lobbying" influences the law, the farm lobby is at present the strongest lobby. That explains why, when the urban population is subjected to a crushing burden of taxation, any suggestion for levying tax on the agricultural sector meets with concerted and strenuous opposition. A modest wealth-tax of Rs. 5 crores annually on the so-far-taxfree agricultural sector immediately excited a murmur of protests which has now risen to a crescendo; while the increase in income-tax on the urban middle-classes which will mean an additional burden of Rs. 14 crores on them, has passed almost unnoticed despite the fact that they are already bearing an excessive burden of direct taxation.

I am not suggesting that agricultural income or wealth should necessarily be taxed. If at least one section of the Indian population is free from the burden of direct taxation which is today stifling industry and constricting economic growth, I am happy that that section of my fellow countrymen enjoy the good fortune. But I am suggesting that the above facts and figures must be seen in the clear light of reason, unclouded by undesirable political overtones by those who criticise the proposal to levy wealth-tax on agricultural lands in cases where the owners are not genuine agriculturists, and who charge the Budget with partiality towards business and industry.

There is a story of a monk who belonged to a religious order where the discipline was that one should not complain even in the most trying circumstances. The monk was seated at dinner and found a mouse in his mug of beer. He loved his beer and was at his wits' end to find a way of letting his predicament be known without committing a breach of discipline. He called the Father Superior and pointing to his neighbour said, "Father, there is no mouse in my brother's mug of beer"! This is the spirit in which the over-taxed urban sector has to deal with the proposal to open up the agricultural front in the Central Budget.

A good deal of controversy seems to have been raised by the farm lobby and other interested persons as to whether a levy of wealth-tax on agricultural lands is within the competence of Parliament. It is true that Entry 86 in the Union List in the Seventh Schedule to the Constitution refers to "Taxes on the capital value of the assets, exclusive of agricultural land, of individuals and companies." Therefore, wealth-tax on agricultural lands would not be covered by that Entry. But tax on agricultural lands is not referred to in the Union List or in the State List or in the Concurrent List. Therefore, it would fall under Entry 97 in the Union List which enables Parliament to legislate in respect of "any other matter not enumerated in List II (State List) or List III (Concurrent List) including any tax not mentioned in either of those Lists." By virtue of Entry 97, and by virtue of Article 248 of the Constitution which vests the residuary power of legislation in Parliament, Parliament is competent to levy wealth-tax on agricultural lands.

Strong political motivation underlying Central and State taxation has been a marked and unpleasant feature of the fiscal policies of India since independence. Agricultural income-tax and land revenue together formed 28% of the tax revenues of the States during the First Plan period, 26% during the Second Plan period, and 19% during the Third Plan period. But during the current year (1968-69) out of the total tax revenues of all the States amounting to Rs. 1,159 crores, only about Rs. 120 crores, i.e. about 10%, is represented by agricultural income-tax and land revenue taken together. In the Maharashtra State the total budgeted tax revenues for the current year are Rs. 191 crores, of which only Rs. 8.6 crores, i.e. 4.6%, is agricultural income-tax and land revenue.

Since the urban vote is of little importance to politicians, and since there is no comparable strong lobby within Parliament for industry and the urban sector, the proposal to levy on the agricultural sector even a small fraction of the burden of taxation borne by the urban population meets with political opposition, while the level of taxation on the industrial sector which effectively retards the economic development of the country meets with little political resistance.

(b) Investments in the Public Sector (Central) total Rs. 3,500 crores, of which Rs. 3,200 crores is invested in 55 running concerns. The crass inefficiency in Public Sector undertakings has resulted in an overall net loss of Rs. 35 crores.

The loans and advances made by the Central Government to companies and corporations in the Public Sector were estimated for the current year at Rs. 284 crores, but the revised estimates just presented show that such loans and advances have amounted to no less than Rs. 450 crores during the current year. It is high time some drastic changes were made in the management of some of the Public Sector undertakings.

(c) The indiscipline of the States has been one of the main causes of excessive taxation by the Centre. During the current year (1968-69) advances to the States were budgeted at Rs. 337 crores, whereas the revised estimates total Rs. 396 crores. During the next year the Centre will make advances or grants to the States to the generous tune of Rs. 1,394 crores, of which only Rs. 176 crores is the amount required to be paid under Article 275(1) of the Constitution.

Meanwhile, every State has introduced a deficit Budget this year. It is interesting to note that during the entire five-year period of the First Plan, the aggregate deficit in the States Budgets was Rs. 17 crores, during the Second Plan period it was Rs. 64 crores and during the Third Plan period it was Rs. 43 crores. These are the figures of deficit for each of the Plan periods of five years. By contrast, in a single year, 1969-70, the States have proposed Budgets of which the aggregate deficit will be a staggering Rs. 250 crores. The level of taxation by the Centre can never be confined within reasonable limits so long as the extravagance of the States continues to be financed by the Centre at such a rate.

(d) The administrative expenditures of the Central Government keep on increasing unchecked, at an alarming rate. The administrative and other services, as distinct from developmental and defence services, were estimated to cost Rs. 298 crores during the current year, but the revised Budget estimates show an expenditure of Rs. 343 crores, while for the next year the budgeted estimate is Rs. 363 crores. Parkinson's Law states that expenditures rise to meet income; unfortunately, governmental expenditures rise to exceed income.

In the fields of personal and corporate taxation, India will have the dubious distinction of remaining, by and large, the highest taxed nation.

The highest marginal rate of personal tax for the current year is 89.4%; it will be 82.5% for the year 1969-70, but the reduction is an illusion, as it is fully offset by an increase in wealth-tax at the slab which produces unearned income falling within the high brackets.

It is interesting to note that out of 12 developing countries of Asia, as many as 6 have a maximum marginal income-tax rate of 50%: they are—Cambodia, Laos, Taiwan, Iran, Korea and Thailand. The last four have the fastest rate of economic growth. The lowest rate of economic growth in the whole of Asia is in India and Burma, where, not coincidentally, the tax burden is the highest. In fact, in the field of personal taxation, taking income-tax and wealth-tax together, the aggregate burden in India is the highest, apart from Burma where at certain slabs the rate is higher. Burma could be easily one of the richest countries of the world, and yet it is one of the poorest because of the fiscal and other economic policies pursued by its Government. Burma should therefore serve not as an example, but as a warning, to the rest of Asia.

In Canada, the Royal Commission on Taxation recently recommended that the highest rate of taxation should be cut from 80% to 50%. In West Germany, the maximum marginal rate of tax is just 53%. In Sweden, a socialist country like ours, the highest rate, which is 65%, has been recently made applicable at a much higher slab than before. The maximum marginal rate of personal taxation is an incentive-giving 55% in Singapore, 60% in the Philippines and 65% in Ceylon.

Professor Ludwig Erhard and Prof. Colin Clark have frequently expressed their firm conviction that the maximum rate of personal taxation should not exceed 50%. The surprising thing is that the same socialists who believe in no taxes at all on agricultural income or property, are zealous in championing the present level of taxation on non-agricultural income.

The Budget could have done much more to encourage private savings, which is the most desperate need of the Indian economy at the moment. The exemption of dividend income upto Rs. 1,000 is almost negatived by the rise in income-tax in the income slab between Rs. 10,000 and Rs. 20,000. It does not compare favourably with the exemption given in Pakistan of dividend income upto Rs. 5,000.

Flying in the face of economic good sense, in the field of corporate taxation, India leads the world. Out of 150 countries of the world, 144 do not exceed the rate of 50% on corporate profits, taking distributed and undistributed profits together. The only countries which levy heavier corporate taxes are Venezuela, Finland, Indonesia, India, Faroe Islands and Burma. Out of these, only two have a level of corporate taxation higher than India, and they are Faroe Islands and Burma. Faroe Islands lie between Great Britain and Iceland and have a total population of only 34,000. Barring them and Burma where industrial activities are at a standstill, no country has ever ventured to tax corporate profits as we do at rates ranging between 50.6% and 65%, in addition to the burden of surtax under the Companies (Profits) Surtax Act. If corporate tax had been reduced by just 5%, it would have cost the Exchequer only about Rs. 33 crores, but its beneficial effects in the direction of economic growth would have far outweighed the small loss in corporate taxes. In fact, it is quite on the cards that the increase in excise and sales tax as a result of such a fiscal stimulus being applied to industry would have made up for the small loss in direct corporate taxes.

Recently, in a brilliant article, "Saving through taxation—Reality or mirage?", Stanley Please, the noted economist, made a careful study of the facts and figures of 19 under-developed countries and came to the conclusion that the doctrine of national saving through taxation is an absolute mirage. He also pointed out how, with increase in taxation, there is a corresponding decline in the rate of both public savings and private savings. Nationalisation of savings is the very worst form of nationalisation Private savings in India have fallen to about 6%, which augurs ill for the economic health of the country.

A great economic revival is impossible at the present level of direct taxation and with the present ideological policies of the Government. An unmistakable indication of this is the fact that only Rs. 69 crores of aggregate fresh capital was issued by companies in 1968, as against Rs. 80 crores in 1967.

Three and a half million unemployed still have their names on Employment Exchanges, while the actual number of the unemployed must be at least twice that figure.

India's exports during the current year may amount to Rs. 1,340 crores, which would only be about two-thirds of the import bill for the year. The Government's foreign indebtedness was Rs. 5,771 crores last month.

It is clear that a massive export effort will be needed to bridge the yawning gap of our balance of payments. Our complacent satisfaction in the increase in our export earnings will be quickly dispelled if we realise that the figures of international trade are on the increase all over the world and that the increases registered by other countries are much more spectacular than ours. Hong Kong's first textile mill was established as late as 1947; and yet her textile exports are three times those of India, if we exclude jute fabrics. The small island of Ceylon today exports more tea than the sub-continent of India.

Foreign investment in a country is a good indicator of its economic health. The total foreign investment in India todate is $ 1500 million; whereas small countries like Mexico and Taiwan have several times larger foreign investments and Australia receives no less than $ 1,000 million foreign investment each year.

The Japanese are shrewd investors, and their investments in India are only 1% of their world total. If conditions do not exist within the country to maximise voluntary savings of our own people, conditions will not also exist to maximise the flow of foreign private investment.

What we badly need is an imaginative Budget which will create a psychological infra-structure of confidence and incentives, setting the scene for the long-awaited turn of the corner in the economic history of India.

Professor John Jewkes of the Oxford University has pointed out the dangers of the infantile belief that a Government must inherently know better than its citizens what is good for those citizens and therefore all increases in public expenditure and tax contribute to the good of the individual.

Taxes are the life-blood of any Government, but it cannot be overlooked that that blood is taken from the arteries of the taxpayer and, therefore, the transfusion is not to be accomplished on dictates of political expediency but in accordance with the principles of justice and good conscience.

"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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