THE UNION BUDGET 1975-76

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By

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All omens were propitious for a really nutritive Budget this year. The inflationary spiral has been brought under control; and the economy is yearning for growth. The tax revenues for the current year will be Rs. 6,128 crores, Rs. 630 crores higher than budgeted. The collection of income-tax on individuals will be higher by Rs. 38 crores than estimated, thus vindicating the view that the Exchequer would not lose but would gain by the reduction last year in the vertiginous rates of personal taxation.

It is regrettable that the Finance Minister whose great ability is beyond question and who ushered in the Green Revolution in the last decade, should have failed to grasp the golden opportunity to pull this country out of stagflation.

The Government has been right in giving top priority to agriculture and energy. But apart from the increased Plan outlay, there is nothing in the fiscal proposals to serve as a stimulus in either field.

Incidentally, the present annual availability of foodgrains is only 160 kilograms *per capita*, whereas it

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was 175 kilograms *per capita* in 1965. The Plan outlay on agriculture has been around 20% only over the years, although 49% of the gross national product comes from agricultural operations and 80% of the population live in rural areas.

The objectives set out in the Budget Speech are indisputably sound. However, the road to economic ruin is paved with good budgetary intentions. Among the most popular lines in the English language are Goldsmith's:

> "*Ill fares the land, to hastening ills a prey*
> *Where wealth accumulates and men decay.*"

How much worse fares the land like India where wealth does *not* accumulate and men decay!

The virtual sameness of the Budget, while Finance Ministers come and go, shows that the shaping of the Budget is the work of bureaucracy. There are some men of outstanding calibre in the Finance Ministry, but there is something in the culture of the North Block which is aggressively conservative. It has been said that the civil service mandarins hate anything new. They fight like mad to remain the same and resist any suggestion for change with an energy that is directly proportional to the radicalness of the change proposed.

What we need today is the type of Budget which would be introduced by a man of Dr. Ludwig Erhard's vision and courage. In June 1948 Erhard ended inflation by putting through the currency reform which he had urged in vain on the Occupation authorities for two years. Without consulting the Allied officials he issued a decree on a Sunday, ending rationing and price controls. He proclaimed, "The only rationing coupon is the Mark". He reduced the rates of income-tax to almost half of what they were before. The Occupation authorities were furious and were frightened out of their wits as to the consequences of what they regarded as a monumental blunder. The U. S. General Clay said, "Herr Erhard, my advisers tell me that you have made a terrible mistake." "Do not listen to them, General," Erhard replied, "my advisers tell *me* the same." In 1949 the experts of the Occupation authorities submitted a Long-term Programme whereby the index of industrial production was to be stepped up by 1953 to 110% of 1936. Erhard's introduction of the free market and lower taxation increased industrial production by 1952-53, not to 110% but to 150% of the 1936 base. In 1955 the *per capita* national income in the U.K. was 35% higher than in Germany. Today the national income *per capita* in Germany is 48.5% higher than in the U.K.

If India is to make any worthwhile progress, sound fiscal policies must be adopted in place of the pedestrian budgetary techniques. Aneurin Bevan, in his last speech in the House of Commons on 3rd November 1959, said:

> "There is one important problem facing representative Parliamentary Government in the whole of the world where it exists. It is being asked

> to solve a problem which so far it has failed to solve: that is, how to reconcile Parliamentary popularity with sound economic planning. So far, nobody on either side of this House has succeeded, and it is a problem which has to be solved if we are to meet the challenge that comes to us from other parts of the world and if we are to grout and to buttress the institutions of Parliamentary Government in the affections of the population."

Like the Budgets of several past years, this year's Budget is again essentially a bullock-cart Budget. A bullock-cart is an ancient and venerable vehicle, but not to be recommended for going places or reaching your destination expeditiously.

Brave words are used by various Ministries suggesting the launching of a massive assault on inflation, stagnation, poverty and unemployment. After identifying the enemy, our first care should be to measure the enemy's strength and employ appropriate weapons. The experience of other countries shows the utility of sophisticated modern instruments which have ensured economic victory against heavy odds. But our Finance Ministry still believes in fighting only with bows and arrows.

The rate of growth in industrial production was about 9% in the Second and Third Plans, while it has been only around 3% since 1966-67. In important items of industrial production we are behind even the Third Plan targets for 1965-66; in other words, we are two

Plans behind. The net national product *per capita*, at 1960-61 prices, was Rs. 335 in 1964-65 and it has barely managed to rise to Rs. 341 after ten years. During the last four years, the number of the unemployed has risen by well over ten million, the *per capita* income has fallen by nearly 3%, and the Rupee has lost 43% of its purchasing power. The growth in real national income in the current year may possibly be zero and, in any event, cannot exceed 1%.

The formation of new assets in the private sector increased at the rate of 9% in 1966-67, while the increase was only 5.6% in 1972-73 and could not have been any higher in later years. This fall of 40% in the growth rate, as compared to the early sixties, is truly alarming.

In 1960, the risk capital raised by companies in the private sector was Rs. 89 crores, while it was only Rs. 70 crores in 1974. Making allowance for the factor of inflation, the risk capital attracted by the investment market is now only one-fourth, in real terms, of the capital which used to be raised 15 years ago. The latest Reserve Bank Index of equity shares is lower than it was in 1961-62, despite the erosion in the value of the Rupee.

Government spokesmen have emphatically asserted that the Budget will not increase prices. Mr. Podsnap in *Our Mutual Friend* refused to see facts which were unpleasant and thought he could push them behind him by a flourish of his hand. Politicians and bureaucrats deem a crisis not to exist until they say that it does. When the Budget aims at raising Rs. 288 crores additional tax revenue (of which Rs. 250 crores will be by way of excise), and further increases inter-State sales tax from 3 to 4%, the most myopic should be able to see that prices will probably rise between 12 and 15% in the coming year. In all likelihood the Budget deficit of Rs. 225 crores will turn out to be over Rs. 500 crores.

During the current year the adverse gap in the balance of trade may exceed Rs. 800 crores. Our indebtedness in foreign exchange will be more than Rs. 7,000 crores next year, and it bids fair to be Rs. 10,000 crores by 1980, by which time we shall have to make repayments amounting to at least Rs. 1,000 crores per year. If India does not want to be a defaulter on the international scene, it must have a quantitative increase in exports exceeding 15% per year. Today the world's total exports add up to $710 billion, out of which India's share is a paltry $3.5 billion, i.e. 0.5%. With the present strangulating controls and ideological obsessions and the pathetic 3% rate of growth in industrial production, it is impossible to see how our exports can be adequately increased.

Dr. Bruno Hake, a West German authority on exports, expressed grave doubts about the utility of the duty-free export zone at Santa Cruz and similar projects in other parts of India. He said, "At Santa Cruz many factories are supposed to work to cater to a growing export market. But I hardly found one or two working. There are too many restrictions and too much emphasis on factories being small-scale and high technology oriented".

Referring to the tremendous potential for such duty-free export zones, Dr. Hake further pointed out that if the restrictions and the red-tape could be removed, at least four million workers could be engaged in four such zones in India, one million in each zone.

The Budget affords no incentives worth the name for economic growth. It should have abolished the corporate surcharge of 5%. That surcharge was introduced as an emergency measure to meet the cost of the Bangla Desh War. The current economic emergency, which calls for its abolition, is even more serious than the emergency which led to its introduction. The present burden of corporate taxation can be gauged from the fact that the total savings in the private corporate sector amounted in 1973-74 to only 3.3% of the total national savings, as against 7.8% in 1960-61. The Budget has not revived the development rebate which contributed more than any other incentive to the industrial development of India since 1955. It has not restored the lower tax rate for priority industries which prevailed in the last decade. The exemption of inter-corporate dividends received from a company registered after 28th February 1975 and engaged in a priority industry, and the wealth-tax exemption in respect of new capital to be issued by a priority industry after the same date, are too insignificant and of too uncertain duration to contribute to the growth of priority industries.

One has only to look at the tax incentives of the fastest developing countries like Brazil, Malaysia and

Singapore to see how ridiculous our so-called incentives are. For instance, in Brazil, the rate of corporate taxation is only 30%, while the maximum rate of personal taxation is 50%. There is a 50% reduction in the income-tax payable by new companies established in backward regions. And this relief is available for a period of 10 to 15 years. Certain priority industries are totally exempt from tax for a period of years, and, further, investments in such industries are tax deductible, i.e., the amount invested in the priority industry is deducted from the taxable income of the investor. To stimulate agriculture, the Brazilian law provides that individual farmers may deduct upto 80% of their net income each year for purposes of investment in improvement and expansion of their farms. All profits derived from exports are excluded from taxable income.

The most deplorable fact is that even the small stimuli which existed under our own system and which led to our industrial development during the last decade have not been revived by the Budget. For instance, the relief in corporate taxation which used to be granted for higher production and payment of higher excise has not been restored. The base on which the 6% tax holiday used to be given to newly established industrial undertakings was recently narrowed by the incomprehensible exclusion of long-term borrowings, and the Budget has not redressed this injustice. The crying need for expansion of priority industries will remain unfulfilled so long as the burden of taxation and the staggering interest rates remain what they are.

The Budget does nothing to mitigate the greatest injustice inherent in the scheme of income-tax, which is that the law adheres to certain monetary limits for various purposes, although the limits now operate, because of inflation, at ridiculously low levels. The apparent continuation of the old rates involves the imposition of an additional hidden tax by inflation. To ask a man to pay tax at the same rates at different slabs as he paid last year is in reality to ask him to pay higher rates, because the relevant slabs in real terms are lowered by the erosion in the value of currency. The present initial exemption of Rs. 6,000 from income-tax is in truth far lower than the limit of Rs. 3,000 which prevailed as early as 1957. The ceiling of Rs. 20,000 for relief on account of provident fund, life insurance premium, etc., which was fixed in 1971, and the ceiling of Rs. 3,000 in respect of income from dividends and bank interest which was also fixed in 1971, have been left unchanged, although to give that relief in real terms the monetary ceiling should have been practically doubled. Many countries—including Chile, Brazil, Denmark, the Netherlands and Canada—have introduced automatic adjustments in tax rates and fiscal monetary ceilings to take care of inflation.

The absence of a sense of justice and fairness in the Budget is typical of our administration today. For instance, Rs. 250 crores accrue every year to provident funds which are maintained for the benefit of the poor and the middle-class who are the worst hit by inflation. But the provident funds are not permitted to earn the current high rates of interest; they are compelled to support Government securities which give them an unrealistically low yield. In other countries the Government subsidizes the poor; in India the poor have to subsidize the Government.

There are three features of the Budget which are most disturbing and may prove to be disastrous in the long run.

First, the Budget displays unconcealed scorn for the judicial process. The small Compensatory (City) Allowance paid to Government employees was held by the Bombay High Court to be non-taxable. That judgment is to be superseded with retrospective effect from 1962. If that judgment had stood, it is not as if tax wrongly deducted would have had to be refunded to all employees for all the past years. The benefit of the judgment would go only to those and only for those years where assessments are pending or where an appeal, rectification or revision application is filed within the short period of time prescribed for each procedure.

The Supreme Court had held in four judgments, which were also followed by the Allahabad, Delhi and Bombay High Courts in various cases, that the accrued liability for gratuity, computed on the basis of an actuarial valuation, should be allowed as a deduction. The Circular of the Central Board of Direct Taxes, dated 21st September 1970, had itself accepted this to be the correct legal position, and that Circular was in force till September 1974. It was on the basis of such gratuity liability being deductible that the commercial profits were determined and the amount of dividend payable to shareholders, the bonus payable to workers, and the ceiling and quantum of managerial remuneration, were computed. Now the Budget proposes to annul, with retrospective effect from the assessment year 1973-74, the law which had become well settled for the last five years as a result of the rulings of the Supreme Court and the High Courts.

The Supreme Court recently decided that higher excise duty was illegally levied on certain strips which were arbitrarily classified as "skelp". Government officials gave whimsical and fanciful definitions of skelp from time to time, and the illegal higher levy on skelp was sought to be supported by various criteria which were mutually contradictory and technically unsustainable. Yet the judgment is to be set at naught by a retrospective amendment which is to take effect from 1962.

In all the above three cases the retrospectivity of the amendments is sought to be supported, in the Explanatory Memorandum on the Finance Bill, by reasons which are clearly unsound and factually incorrect. Such retrospective provisions can only serve to bring the law into contempt. They imply that the citizen's right of appeal is illusory, that the Executive is omnipotent, and that the hapless citizen should never hope to win in his fight against the State, however illegal the State's action might be. Even the very cases in which the judgments were rendered by the Supreme Court and the High Courts have not been spared from the retrospective operation. Never in the history of India has any Budget shown such total contempt for the rule of law.

Secondly, the newly proposed levy of 1% excise on all unspecified articles manufactured in a factory, will not only have an inflationary effect but it will do something infinitely worse. A nation's growth and prosperity depend upon the wise use of (a) tangible resources, (b) intangible resources like ability, energy and enterprise, and (c) time. The intangible resources and the time of the citizens are far more important than the tangible resources of the country. You can print money; you cannot print time. Time is more perishable than anything else; you cannot carry forward today's hours to tomorrow. No nation has a future where the administrative set-up ensures tragic waste of time and energy of the citizens. Out of our population of 600 million, at least 200 million may be taken as able and willing to work. At the rate of 8 working-hours, our country has 1,600 million man-hours daily available for national development. The perpetuation of our poverty is primarily due to the fact that no value is put on these priceless man-hours which are wasted in utter trivialities involved in foolish laws and regulations. How much time and energy will be wasted in collecting the new 1% levy from lakhs of factories all over India!

Mr. A. P. Sharma, the Minister of State for Industries, mentioned in Parliament just a few days ago that one factory out of every three factories in the small-scale sector is bogus and has been brought into existence merely to get the benefit of certain tax exemptions. With this official knowledge, the Government still proposes that the new levy should apply to all those who employ at least 50 workers and use power or who employ at least 100 workers and do not use power.

The Financial Memorandum mentions the amount of Rs. 3 crores as the cost of recruiting new staff to cope with the work of collecting the new 1% levy. But several crores will have to be spent also by the factory owners on recruiting their own staff to deal with the problems arising from their new fiscal obligations.

The Government of India is the largest single creator of unproductive white-collar jobs in the world. It has turned a great nation into a clerical department of the administration. Every Finance Bill should have appended to it not only the Financial Memorandum showing the additional administrative expenditure entailed by the new levies, but should also show how many millions of man-hours will be unproductively used up as a result of the Budget proposals.

Thirdly, the Budget aims at dealing a calculated blow to free enterprise. The concept of a mixed economy is slowly giving way to larger and larger concentration of resources and assets in the hands of the monolithic State. The Plan outlay, which is necessarily in the public sector, would increase by 23%—from Rs. 4,844 crores in 1974-75 to Rs. 5,960 crores in 1975-76—while the private sector will have no scope for improving upon the rate of 5% as regards the formation of new assets.

Further, 15% of the interest paid by companies on deposits received from the public would now be disallowed in calculating the taxable corporate profits. Deposits with companies total Rs. 800 crores, i.e. only about 7% of the total deposits of Rs. 11,600 crores which are with the banks. But even this limited source of financial sustenance for private enterprise is now sought to be discouraged by the disallowance of interest which should be fully allowed on every known principle of accounting and taxation.

Again, whereas currently companies have to deduct tax from interest paid by them exceeding Rs. 400 at a time, the Finance Bill will compel them to make a calculation of all the amounts of interest paid to a single depositor at different times and deduct tax if the total of the different amounts of interest exceeds Rs. 400 in a year. This is obviously intended to put one more hurdle in the way of the public placing deposits with the corporate sector. No such deduction of tax is required to be made by banks paying interest on deposits.

One of the main reasons why our Budgets are so unsatisfactory is the unnecessary veil of secrecy about budgetary provisions, which prevents any public discussion of the issues involved. Sir Richard Clarke, who had 15 years' experience as a Treasury official in the U.K., has publicly stated that the long-term fiscal strategy should be put in the public arena. He said:

> "The problems of long-term tax policy should surely be debated openly with the facts on the table, just like those of defence or education. In my opinion, all Governments should have just the same *duty* to publish their long-term taxation policy as they now have to publish their expenditure policy."

Mr. Patrick Jenkin, an eminent Member of the U.K. Parliament, has emphatically asserted that in order to have a sound Budget there should be less secrecy and more consultation, particularly consultation with the professionals. In Britain the Government has started publishing Green Papers regarding all major innovations in taxation. In the U.S.A. the Government invites public debate and discussion regarding various fiscal measures before the introduction of the Budget. In Canada the rates of corporate taxation are announced in advance for several years. In 1972 Canada announced the rate of 50% corporate tax and laid down in advance that the rate would be reduced by 1% every year till it reaches 46% in 1976, so that industries could plan five years ahead. India still follows the hugger-mugger budgetary practices which are at least half a century out of date.

In sum, the next twelve months may prove that a fresh lease of life has been given to stagnation and inflation and one more wound has been inflicted on the badly mauled body of economic growth. The best that can be said in favour of the Budget is that it will not aggravate the depression, dismay and disquiet which have marked the Indian economic scene for the last few years.

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