THE UNION BUDGET 1977-78

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By

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Visionaries expect the Finance Minister to be the imaginative allocator of the nation's financial resources and the oracular orchestrator of the people's energies and enterprises, skills and disciplines. In practice, the Minister is buffeted by the cross-currents of political pressures and by an unimaginable volume of contradictory advice proferred from all sides.

Dr. Colin Clark observed that the welfare State has become a Father Christmas who comes round on Boxing Day "to collect the entire cost of the gifts he has handed out, together with a substantial commission for himself for having organised the distribution". In India we have the top-heavy bureaucracy of a welfare State without the welfare.

Prodigality in non-Plan expenditure creeps onwards with a noiseless and stealthy step; while of Plan expenditure, according to a former Finance Minister's estimate, about 40% goes down the drain. The total disbursements of the Central Government will come to Rs. 15,500 crores in the current year, as against Rs. 5,500 crores in 1969-70.

The main problem facing Mr. H. M. Patel—and the entire nation—is that we have inherited a system which has an in-built unfailing mechanism for ensuring perpetually increasing expenditure, while the laws of economics rule out any such device on the revenue side. No budget can amend the laws of economics any more than it can the laws of dynamics.

The constraints under which the budget has been formulated are plain. The Government is not writing on a clean slate. Burdened by the onerous inheritance of vast commitments on projects which were based on

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priorities lacking in both stability and economic wisdom, and faced with the task of conceiving and presenting the budget in wholly inadequate time, the Finance Minister has done a meritorious job.

The situation in which Mr. H. M. Patel found himself when presenting this year's budget is fairly close to that of Marshal Foch when he sent the historic despatch from the battle-field in the First World War: "My left wing is retreating. My soft centre is crumbling. The situation is excellent. I attack!"

The adverse factors—a legacy of the past—which constitute the background of the budget are truly formidable. At the time when the budget was presented, the wholesale price index stood 10.7% above the level twelve months earlier. Between March 1976 and March 1977 money supply had increased by about 19%; while the rate of economic growth was hardly 1%—with the consequence that the rate of inflation was 12% on a point-to-point basis. In ten States industry is slashed by power cuts ranging from 15 to 50%.

The investment market continues to be sluggish. The capital raised by non-Government companies declined from Rs. 96 crores in 1975 to Rs. 79 crores in 1976; while those companies' savings plummeted from Rs. 843 crores in 1974-75 to Rs. 520 crores in 1975-76. The number of job seekers on the registers of employment exchanges has doubled to 10 million in the last five years, while some 40 million are estimated to be unemployed.

It would be idle to pretend that the budget is the full-fledged Janata budget which is calculated to prepare India for the twenty-first century,—the Finance Minister himself has expressly disowned such a claim. But the Minister has sincerely and valiantly taken the first small step towards achieving the goals and the ideals embodied in the manifesto of the Janata Party.

Figures are concrete; while quality is an abstract concept. That is why debates rage in Parliament and in the press about the various quantitative allocations made in the budget, while it is generally forgotten that it is the quality of the Plan expenditure which is infinitely more important than the size of the amounts set apart for various items. The impact of the budget on the

national economy does not depend so much on the allocations made as on the perspicacity with which the expenditure is incurred and the trouble taken to bring the outlay to fruition. The same budget may breed lilacs out of the dead land and stir dull roots with spring rain,—or it may sap the nation's strength and undermine growth. You can no more expect a nation to have economic strength and growth by mere budgetary allocations than you can expect a child to grow up cultured and healthy because his father has set apart amounts to be spent on his education and medical care. Secondly, the spirit underlying the budget is even more important than its letter. All things considered, this year's budget should prove to be a nutritive one, if its provisions are administered in a spirit of fairness, the outlays are monitored with care, and the people co-operate with grace.

Among the basic objectives enunciated in the Janata Party's manifesto are—(a) the primacy of agriculture as an imperative priority, (b) the development of industries in rural areas, (c) affirmation of the right to work and a full employment strategy, (d) indigenous technology and know-how for self-reliance, (e) emphasis on wage goods production for mass consumption, and (f) development of small-scale industries. Something is sought to be done in this budget towards the fulfilment of each of these objectives.

(*a*) Rs. 3,024 crores—30.4% of the Plan outlay—will be spent on subjects related to agriculture—irrigation, rural roads and facilities for drinking water, rural development including electrification, extension of post, telegraph and telephone facilities to the rural areas, etc.

(*b*) Incentives are provided—but far too meagre—for small industrial units in the rural areas.

(*c*) The Plan outlay of Rs. 9,960 crores—an increase of 27% over the previous year—would itself create many new jobs, if the expenditure is incurred wisely. Mr. H. M. Patel has rightly made no separate allocation for a crash employment programme, because employment is merely a by-product of well-planned economic growth. Rs. 35 crores is fairly proposed to be spent on Khadi and village industries, though the expecta-

tion that it would give employment to 25 lakhs of persons is open to doubt. Expenditure of just Rs. 140 for creating a new job for a year sounds too good to be true.

(*d*) Investment allowance is proposed to be raised from 25% to 35% in respect of plant and machinery which is intended to be used for the production of articles by using any technology or know-how acquired by the assessee from a laboratory of the Government, a public sector company or a University. The principle of logic or economics on which the same benefit is denied in cases where the know-how or technology is developed by the assessee himself or is developed in the private sector—is not clear. Astute taxpayers may buy know-how from a Government laboratory and use it in the year in which the higher investment allowance is claimed and allowed, and thereafter start using their own superior technology—since the wasted cost of buying the Government technology may be substantially less than the saving in tax.

(e) No increase is proposed in excise on wage goods produced for mass consumption. Biris and cigarettes are the only exceptions. It was Napoleon Bonaparte who said that he found vices very good patriots and wanted to know which of the virtues would give him so much revenue as he derived from the love of brandy. Tobacco and opium have broad backs, said Emerson, and will cheerfully carry the load of armies.

(*f*) A stimulus is proposed to be given to small-scale industries by the relief in excise to handlooms and powerlooms, to small paper mills and mini steel plants, and by the exemption from the general excise of 2% for small-scale industries with a turnover not exceeding Rs. 30 lakhs.

Several misconceived criticisms, stemming from prejudice or ignorance, are bandied about, specially when any concession is sought to be given to the corporate sector. The facts speak for themselves.

(*i*) What we call "big" business is in truth pathetically small in the context of the modern

emphasis on economies of scale and technological methods of mass production. That is why Indian goods have to be subsidised by the Government in order that they may be competitive in the world markets. One unit in Taiwan produces more polyester staple fibre in a month than all the four manufacturers in India produce in a whole year.

(*ii*) We are right in heeding Gandhiji's advice that "it is not mass production, it is only production by the masses that could do the trick". Having regard to the problem of unemployment in the country, we protect our labour force against what are regarded as the ravages of automation. But it is often overlooked that such a policy is bound to have its effect on the price of the end-product. A textile mill in Hongkong producing 2 lakh metres of cloth per day would employ less than a thousand workers in the three shifts taken together, while a mill in India would need at least 5,000 workers to achieve the same production level.

(*iii*) Several industries already have their capacity "frozen" by the existing constraints. To take the oldest Indian industry, the textile mills produced 4,100 million metres of cloth in 1953-54, while in 1975-76 their production aggregated to no more than 3,961 million metres. In 1951-52 they had 79% of the textile market; today it is 50% as a result of the expansion of powerlooms and handlooms.

(*iv*) The Government is the greatest beneficiary of the expansion of the corporate sector—way above the "capitalist" shareholder. For every Rs. 100 earned as profits by the corporate sector, the public exchequer gains Rs. 780:
Rs. 527 as excise,
Rs. 135 as sales tax,
Rs. 118 as corporation tax.

(*v*) Savings in private hands invariably fructify far better than public savings. In the private sector the return (before interest and tax) on the capital employed is 13.5%; whereas in the

public sector (which has made commendable progress recently) it is 4.8%.

For the corporate sector the budget has the very salutary provision of extending the investment allowance (which was uptil now confined to 32 industries) to all industries with the exception of certain specified activities to which the Government accords low priority.

While the material circumstances have remained exactly the same over all the years, closely held industrial companies were compelled for some years to distribute a specified percentage of their net profits by way of dividends; then came a period when the compulsion was lifted, followed by another period when the compulsion was reimposed. This year's budget lifts that ill-conceived compulsion; and one can only hope that it will never be revived again.

Under the last year's budget, companies had the option of depositing an amount equivalent to the 5% surcharge on corporation tax with the Industrial Development Bank of India, and the deposit was repayable after five years. The Finance Bill now proposes to abolish this option. Having regard to the recessionary state of industry, the abolition of the option will not subserve the larger public interest.

Perhaps the least satisfactory provision of the Finance Bill is Section 72A proposed to be inserted in the Income-tax Act.

300 large and medium scale units, and 10,000 small units are on the sick list — a distressingly large number of them being terminal cases. With so many sick units darkening the economic scene, the proposal is to induce profitable concerns to absorb sick units by providing that the accumulated losses and unabsorbed depreciation of a sick unit carried forward from past years would be allowed to be set off against the profits of the company with which the sick unit is amalgamated. (We may call the sick unit the "amalgamating company", and the company absorbing it the "amalgamated company".)

But the section is so drafted as to thwart the good intentions of the Finance Minister. It requires that the amalgamation must be completed without knowing

whether the benefit of the section would be available at all. Three distinct sets of hurdles have to be overcome later, and all of them depend upon the subjective and unpredictable judgment of a faceless bureaucracy.

First, the imperative conditions are that the amalgamating company should not be "financially viable", that the amalgamation should be in "the public interest" and that the amalgamation should "facilitate the rehabilitation or revival of the business of the amalgamating company". There can be a wide divergence of opinion whether, on the facts of a given case, all these cumulative conditions are fulfilled or not.

Secondly, a specified authority must make a recommendation to the Central Government that the aforesaid conditions are all satisfied. It is then for the Central Government to make or not to make a declaration accepting the recommendation of the specified authority. There is no appeal against the refusal of the specified authority to make a recommendation, nor against the refusal of the Central Government to accept the recommendation.

Even if the recommendation and the declaration are both made, still the benefit of the section would be denied unless a third set of hurdles is overcome. The business of the amalgamating company should continue to be carried on "without any modification or reorganisation" except those which are approved by the Central Government. Now, most sick units would necessarily need modification or reorganisation of their business if they are to be restored to health; and no business can be carried on efficiently if its owner is prevented from effecting any modification or reorganisation without time-guzzling governmental approval. Further, the amalgamated company must furnish a certificate from the specified authority "to the effect that adequate steps have been taken by that company for the rehabilitation or revival of the business of the amalgamating company".

Mr. H. M. Patel's laudable objective surely deserved better treatment at the hands of the sedentary mandarins of his ministry. The section will never fulfil its purpose of assisting the emergency department of the national clinic for lame ducks and job-preservation.

Raising the limit of income-tax exemption from Rs. 8,000 to Rs. 10,000 will give much needed and long overdue relief to 8 lakh assessees. This provision was one of the certainties of the budget which was otherwise shrouded in secrecy, since it was one of the express promises in the Janata Party manifesto.

Bernard Shaw referred to the unprofitable exercise conducted at universities which consisted in demonstrating that human rights did not exist. Learned men would spend hours in showing to their own satisfaction that the whole idea was chimerical. Shaw added that, unhappily, people persisted in their obstinate belief that they did indeed possess certain fundamental rights. They were prepared to defend them, to demand them, even to resort to force if they did not obtain them.

A somewhat similar situation exists as regards penal rates of taxation. Ideologues and academics spend hours in convincing themselves that high rates of personal taxation are essential in a socialist economy. The people persist in their obstinate belief that the State is not entitled to take more than half of their income. They are prepared to resort to various devices, even at the risk of being prosecuted, to keep a fair share of their own earnings. Dr. Ludwig Erhard, the author of the German miracle, and Professor Colin Clark have been of the definite view that the maximum rate of personal taxation should not exceed 50%. Professor Kaldor, the eminent socialist, advocated the maximum rate of 45% and said, "These confiscatory tax rates apply only to a small minority of people who cannot avoid their incidence and their long run effect is bound to be wholly pernicious, both in penalising the prospects of certain careers which are vital from the national point of view, and in undermining public morality." The undeniable truth of Professor Kaldor's observation is borne out by Dr. Crick, the British Nobel Laureate, going into tax exile in the U.S. this year to provide a satisfactory income for the remainder of his life, and another British Nobel Laureate, Dr. Perutz, contemplating a similar move as a result of what the *Times* (of London) called "the nonsensical state of our personal tax structure". In the United Kingdom the maxi-

mum rate of income-tax on earned income is 83%, and on unearned income 98%.

It is not the *amount* of the increase in the rates of income-tax and wealth-tax but the *principle* underlying the increase which is likely to arouse public anxiety. After 30 years of confiscatory taxation, the Finance Act last year, for the first time, brought personal taxation down to reasonable levels. The present Government will have to make a very careful policy decision as to whether an increase in personal taxation would be in the public interest.

The proposal to apply the increased rates of wealth-tax from the current assessment year is a reversal of the sound policy, which was declared by Shri Morarji Desai himself when he was the Finance Minister, that all changes, as far as possible, should apply to income and wealth prospectively and not retrospectively.

Two of the most beneficial provisions of the Finance Bill are the changes in the law relating to charities and to capital gains tax.

The Taxation Laws (Amendment) Bill, 1973, contained a provision denying tax exemption to any charity which made investments in equity shares of limited companies. The Select Committee made recommendations upholding the principle to a limited extent. Mr. H. M. Patel, a member of the Select Committee, put in a minute of dissent taking the liberal view that the provisions recommended by the Select Committee with regard to charitable trusts were "unduly onerous". When the Bill was finally enacted into law as the Taxation Laws (Amendment) Act, 1975, the Act imposed harsher and more severe restrictions on charities than those contemplated by the Select Committee, and required charities to liquidate all their equity investments in shares by 31st March 1978,—otherwise their entire income (of which the dividend income may form an insignificant part) would be taxable. Mr. H. M. Patel has very rightly postponed the date of disinvestment by three years, so that the matter may receive fresh consideration in the meanwhile.

The tax on capital gains is for the first time sought to be put on a rational basis. Lord Shawcross described the tax on capital gains as the greatest fraud in the history of fiscal legislation. He called it a fraud because in times of inflation when a citizen sells his capital asset and gets in depreciated currency a higher amount than what he had paid for it, he is asked to pay tax on his so-called capital gains, while in real terms, if an allowance is made for the debasement of the currency, he may have actually made a loss.

The Finance Minister has proposed three salutary changes in the existing scheme of capital gains taxation. Under the current law, an asset is required to be held for five years in order that gains from its sale may be taxed more lightly as long-term capital gains. This period is now reduced to three years. Secondly, under the existing law, the assessee is entitled to deduct from the sale proceeds the fair market value of the capital asset as on 1st January 1954 in place of the actual cost of acquisition. Under the budget proposals the assessee will be entitled to deduct the fair market value as on 1st January 1964. This is distinctly beneficial, since inflation had steadily pushed up prices between 1954 and 1964. Thirdly, and most importantly, capital gains would hereafter be exempted from tax if the proceeds of any asset sold—whether house property, shares, jewellery, or any other asset—are reinvested within six months in shares, bank deposits, units of the Unit Trust or other specified assets. This relief is subject to the fair condition that the new investment made out of the sale proceeds should be held for a period of at least three years.

The Finance Minister has been wrongly criticised for taking credit for Rs. 800 crores which he proposes to draw from India's foreign exchange reserves of Rs. 3,500 crores. The criticism that this amounts to the exercise of a "soft option" which has merely served to reduce a larger deficit to Rs. 72 crores, is ill-founded. First, drawing upon the foreign exchange reserves to the extent of Rs. 800 crores is fully justified on the sound economic principle of making timely use of available resources. A thinker once said that "everything is yours to use, nothing is yours to keep"—that is "the great law

of the universe" which governs your money and brains, your time, energy and life itself. How can the Finance Minister be faulted for having chosen to act upon this great law of the universe?

Secondly, the effect of drawing Rs. 800 crores from the foreign exchange reserves is bound to be deflationary when money is remitted to foreign countries, particularly to buy certain goods in order to bring down their prices in India which are artificially high due to acute scarcity. Thirdly, the argument that by drawing more than Rs. 800 crores, the budget could have been converted into a surplus budget is, again, without any validity. There is a Plimsoll line above which it would be dangerous to import goods because of the risk of causing a recession in vital areas of our national economy. There are no facts which would indicate that Rs. 800 crores is not the right or optimum figure, having regard to all the prevailing circumstances.

As against the deficit of Rs. 425 crores last year, the estimated deficit of Rs. 72 crores for the current year is the lowest since 1961-62 on any meaningful comparison. There is a strong determination underlying the budget to contain inflation at all costs. The negligible deficit and the continuance of the compulsory deposit scheme for income-tax payers for further two years are parts of the anti-inflation strategy.

When we come to the end of the current financial year, shall we find inflationary pressures contained and the estimated deficit not increased?

There are various factors which do not serve as propitious omens:

(*i*) On several commodities, the excise duties in India are the heaviest in the world. Increase in excise must inevitably mean increase in sales tax and thus there is a compounded rise in the cost of goods to the consumer. This year the increase in indirect taxation will be of the order of Rs. 142 crores.

(*ii*) While the Plan outlay of Rs. 9,960 crores is eminently in the national interest, it would be a pleasant surprise if it does not result in an increase in money supply of 13 to 15%.

(*iii*) The defence expenditure will be higher by 5.5% as compared to the last year.

(*iv*) Rs. 130 crores will be utilised from the funds collected under the compuslory deposit schemes.

(*v*) The proposal to decrease the non-Plan expenditure by Rs. 130 crores may flounder upon the rock of increased dearness allowance payable to Government employees.

But as against these factors, we have abundance of various essential items, and thus the picture is different from what it was in 1972-74 when inflation raged in the wake of scarcity. Coal India is sitting on a pithead stock of more than 13 million tonnes. 1.5 million tonnes of finished steel, valued at Rs. 225 crores, are awaiting buyers. 23 million tonnes of foodgrains are stored in conditions which are wholeheartedly approved by rats. And there is a mountain of coarse cloth awaiting disposal. If trade and industry—including the public sector—co-operate fully with the Government, the demon of inflation can and will be conquered.

Herbert Spencer said: "The more numerous public instrumentalities become, the more is there generated in citizens the notion that everything is to be done for them, and nothing by them. Every generation is made less familiar with the attainment of desired ends by individual actions or private agencies; until, eventually, governmental agencies come to be thought of as the only available agencies." We, the people, have numerous agencies available to us for holding the price line.

One of the graces of public life in mature democracies is the well respected convention of giving a new party in power a fair and reasonable chance of proving the soundness of its policies. Such consideration is the least which the Janata Government is entitled to expect after having restored all the basic freedoms to the people.

—*Courtesy* "The Illustrated Weekly of India"

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