THE UNION BUDGET 1980-81

N. A. PALKHIVALA

FORUM OF FREE ENTERPRISE
PIRAMAL MANSION, 235 DR. D. N. ROAD,
BOMBAY 400 001.

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By

N. A. Palkhivala

Elections can change the governing faces; budgets can change the face of the State. But, in order to achieve that, the Budget must transcend the orthodox limits of "safety" to which we have grown so accustomed over the last 30 years. Is the new Budget a take-away budget or a give-away budget? The answer is that it is neither.

In fairness to the Finance Minister, one must take into account the enormous problems he has had to contend with. The Budget for 1980-81 has come at a time of acute economic distress. During the last financial year there was a fall of 1% in industrial production, 10% in agriculture, and 3% in the gross national product. These minus figures were balanced by a huge plus figure of 20% in inflation.

The steel plants do not have power; the power plants do not have coal; the coal-mines do not have wagons; and the cement plants have neither power, nor coal, nor wagons. An estimate of a loss of Rs 10,000 crores to the nation during the last 12 months on account of these abysmal deficiencies in the infrastructure would not be off the mark.

On the other hand, there are factors operating in India which are highly favourable to the Finance Ministry. India is the only country in the world where the Government ordains that citizens shall borrow from government-owned banks at 19% rate of interest, while the Government itself borrows from the citizens at ridiculously low rates ranging from 6 to 7.5%. Public deposits in the banks total Rs 32,000 crores; and out of this amount 44% is required by compulsion of law to be invested in government bonds and securities on which the interest paid is about half of what it should be in justice and equity. Millions of people whose life savings are in the form of balances to their credit in provident fund accounts—which are again required to be invested in government securities—have to put up with this poor rate of return. Indian savings are as high as 19 to 20% of the national income, of which the bulk is appropriated by the Government as extraordinarily cheap money.

Besides, while in other countries the government subsidises industry, in India industry has to subsidise the government. For instance, the Government is the biggest buyer of cement and its purchases are at a controlled price which is below the cost of production. The Indian producer is paid the mean price of Rs 205 per tonne, while the Government imports cement at two and a half times that price.

Truly, we Indians are a "low arousal" people. We endure injustice and unfairness with feudalistic servility and fatalistic resignation.

Indubitable good points of the Budget

Mr. R. Venkataraman's Budget is a well-dressed Budget. It is highly presentable. Its first priority has rightly been to give some immediate relief to the common man. Citizens pay their income-tax in sorrow and their excise in anger. The sorrow has

been assuaged by reducing the income-tax rates at all levels, and by raising the exemption limit for personal income-tax from Rs 10,000 to Rs 12,000, and for wealth-tax from Rs 1,00,000 to Rs 1,50,000; while the anger has been palliated by the reduction of excise on articles of common consumption.

Few people will stop to ponder that the income-tax exemption limit of Rs 10,000 which was introduced in 1978 is equivalent to Rs 13,100 today, and that the wealth-tax exemption limit of Rs 1,00,000 which was fixed in 1964 now equals Rs 3,61,000. We are experiencing a "fiscal drag" where, even after tax reliefs, citizens are worse off than before, because the reliefs do not keep pace with inflation. We do not have the system—which prevails in Denmark, the Netherlands, Canada and Australia—of automatic indexing of exemption limits and other tax reliefs by reference to the rate of inflation.

The allocations for agriculture and rural development and for the advancement of the small-scale sector are unexceptionable. However, a tax system is a nation's definition of "social equity", and our tax laws have no notion of social equity as between the urban and the rural sectors. While many eminent thinkers have been repeatedly highlighting for two decades the anomaly that income-tax is not levied on agricultural income, the Budget now proposes to abolish the existing wealth-tax on agricultural property. One of the grounds for its abolition is that "the valuation of agricultural land has posed difficulties leading to complaints of harassment". If this argument is valid, most urban assets (barring cash and goods for which stock exchange and commodity exchange quotations are available) should be given the same compassionate and sensitive consideration!

The monster of inflation

Will the Budget achieve the Finance Minister's objective to "set the economy on the path of stability and growth"? The two monsters devouring stability are inflation and chronic tinkering with the law, and both continue to be handsomely fed. Inflation is the invisible tax which has never been passed by Parliament. We are likely to have a 15 to 20% dose of it during the current year.

Just before the Budget, came the three heavy increases—Rs 2,100 crores in the price of oil and petroleum products, Rs 300 crores in that of fertilisers, and over Rs 200 crores in railway freight. The Budget has increased the excise on dozens of items which will net the Government over Rs 200 crores; and it provides for an interest tax of 7% on loans given by banks, which will amount to over Rs 100 crores in the course of the year.

The snowballing effect of these increases, culminating in higher sales tax, is bound to be felt all round, resulting in a winter of discontent. A thick cloud of unabating inflation will settle upon the entire economy.

Inflation is the inevitable result of productivity not keeping pace with the increase in money supply. The lowest productivity is in the public sector where we have invested Rs 14,173 crores and get a return of Rs 193 crores before tax. This return of 1.4% may be compared with the 8% return in 415 companies in the private sector selected for a sample survey by the Reserve Bank of India. The last Budget contemplated a deficit of Rs 1,382 crores which ultimately crystallised at Rs 2,700 crores. It would not be surprising if we end the current year with a deficit of about Rs 2,500 crores in place of the budgeted deficit of Rs 1,417 crores.

The burden of taxation that we bear is far greater than what Sydney Smith wrote about in the *Edinburgh Review* in 1820:

"The schoolboy whips his taxed top; the beardless youth manages his taxed horse, with a taxed bridle, on a taxed road; and the dying Englishman, pouring his medicine, which has paid 7%, into a spoon that has paid 15%, flings himself back upon his chintz bed, which has paid 22%, and expires into the arms of an apothecary who has paid a licence fee of £100 for the privilege of putting him to death. His whole property is then immediately taxed from 2% to 10%. Besides the probate, large fees are demanded for burying him in the chancel. His virtues are handed down to posterity on taxed marble, and he will then be gathered to his fathers to be taxed no more."

Instability and unfairness

Stability in fiscal laws is to a nation what stability in family life is to an individual. So far from ensuring stability, the Budget will positively unsettle the law now established as a result of several years' litigation. The least defensible part of the Budget is the set of provisions which seek to give retrospective operation to various amendments. Retrospective

legislation is the bureaucrat's dream but the tax-payer's nightmare.

Section 80AA is sought to be introduced with retrospective effect from 1st April 1968. The effect of that section would be to reduce drastically the reliefs available under sections 80HH to 80TT which deal inter alia with inter-corporate dividends, and royalties, commission or fees received in India and abroad. The object of the new section is to supersede the judgment of the Supreme Court in *Cloth Traders Ltd* v. *CIT* (118 ITR 243) which held that the exemption is available in respect of the gross income and not the net income after deducting expenses. (The question as to what expenses are rightly to be deducted by the revenue in order to arrive at the income qualifying for exemption will involve a 20-year litigation in several cases.) One can understand the legislature changing the law prospectively. But it is grossly unfair to hit, with retrospective effect for the past 12 years, those citizens who had arranged their affairs and effected business transactions on the faith of the well-settled law.

Discretionary trusts are those trusts where the individual shares of the beneficiaries are indeterminate or unknown. Such trusts are generally assessable at the rate appropriate to an association of persons or a unit of assessment. Numerous trusts have been created since 1961 on the faith of the existing law. The Finance (No. 2) Bill, 1980, proposes to amend section 164 of the Income-tax Act without saving those testamentary and non-testamentary trusts which have already come into operation and which cannot now be changed. Under the provisions of the Bill the penal rate, viz. the maximum marginal rate of income-tax, will apply to several of such trusts. The deplorable tendency of adversely affecting rights created, and business dealings entered into, on the faith of the existing law has grown in fiscal legislations introduced by the Government of India during the last ten years. It needs to be checked by an alert and strong body of opinion both within and outside Parliament.

The most shining beacon of fiscal arbitrariness is the retrospective effect from 1972 sought to be given to an amendment which seeks to exclude borrowed capital from the scope of section 80-J of the Income-tax Act and which will affect lakhs of shareholders. That section grants relief to the extent of 6% of the capital employed to newly established undertakings. The expression "capital employed"—whether taken in its legal sense or its dictionary meaning or its popular or commercial sense—must include borrowed moneys. Parliament could not possibly have intended to favour the affluent assessees who are able to employ their own capital and to discriminate against the indigent who have to borrow funds to finance their undertakings. The point is truly elementary and the attempts of the revenue to exclude borrowed moneys were emphatically negatived by the Calcutta, Madras and Allahabad High Courts. Bureaucratic obstinacy now seeks to triumph, by a retrospective amendment, over commonsense and well-settled law.

There is no doubt about Mr. Venkataraman's keen and sincere desire to simplify the tax structure. Unfortunately, the Income-tax Act will emerge, after the passage of the Finance Bill, in a more complex form than ever before.

Two things strike me with trepidation and amazement—the precipitate and chronic tinkering with the law by the powers that be and the inexhaustible patience of the Indian public. The Income-tax Act 1961, which repealed the 1922 Act, was meant to put the income-tax law on a stable basis. But those who thought that the legislature's passion for mutability was satisfied have been rudely awakened. Uptil 1979 the 1961 Act has undergone, on a rough reckoning, 695 insertions, 737 substitutions and 205 deletions.

The Income-tax Rules are amended with the same total disregard for public convenience. Whole new sets of amendments to the Rules were promulgated seven times in 1976, nine times in 1977, again nine times in 1978, and eight times in 1979.

Modern income-tax, as we know it, was first introduced by William Pitt in the British Parliament on 3rd December 1798. Since it was intended to be a temporary measure to finance the war against Napoleon, the rates used to be prescribed by annual Finance Acts. Now that income-tax has become a permanent feature, it is high time the rates were embodied in the Income-tax Act itself, just as the rates of excise, customs and wealth-tax are in the substantive enactments imposing those levies. **In order to impart stability to the tax structure, the rates of corporate and personal taxation should be laid down for a period of three to five years, as is being done in several well-governed countries.**

It is a pity that the exemption of capital gains from income-tax introduced in the Budget of 1978 upon condition that the gains are invested in bank deposits, etc., has not been revived. Lord Shawcross called the capital gains tax "the greatest fraud in the history of fiscal legislation", since it is a mere tax upon inflation and empowers the State to tax even that citizen who has in real terms made a positive capital loss. Illustrations of this flagrant injustice are not difficult to envisage, bearing in mind that the rupee today is half of its value in 1970 and a quarter of its value in 1958. For instance, where a man who had bought shares for Rs 1,00,000 in 1970 sells them today for Rs 1,75,000, or who had bought shares for Rs 1,00,000 in 1958 sells them today for Rs 3,00,000,—in either case he makes a positive capital loss in real terms because he is getting his sale price in debased currency which is lower in value than the actual cost of the shares to him. Yet in both cases the State is unfair enough to levy on him capital gains tax!

Poor incentives for industry and exports

While the Budget has commendably given much-needed reliefs in personal taxation, it has done little for industry and the corporate sector.

The Budget contains nothing to spur industrial growth. Industry contributes 79% of the Central Government's revenues, excluding the direct taxes paid by individuals employed in industry. Yet industry has been almost wholly neglected by the Budget. The increase effected last year in corporate surcharge from 5% to 7.5% has not been removed. The incentive of 25% rebate in excise for increased production has been allowed to lapse.

The proposed section 80-I (in place of the existing section 80-J) seeks to grant relief to new industrial undertakings for seven years on the basis of a percentage of profits and not of the capital employed. Surely, the Government is fully aware of the fact that in most cases the relief will be illusory for at least half of the period, since very few new industrial undertakings have any taxable profits in the first three or four years. Further, sub-section (6) of the proposed section 80-I has very sinister implications for the taxpayer. Its effect will be that even if the losses of a newly established undertaking in early years are fully set off against the other income of the assessee, still the losses so set off will be notionally carried forward and adjusted against the profits of the new undertaking in the latter part of the seven-year period, with the result that even in the years of profit the assessee may get no exemption under section 80-I!

In these days of galloping inflation, the proposed additional depreciation in the first year, amounting to 50% of the normal depreciation, can hardly afford any significant relief. It gives no relief from tax but only postpones the payment of some tax from the year of installation to the years immediately following. The Chokshi Committee had rightly recommended much more liberal rules for depreciation. In the United Kingdom, the assessee has full freedom to claim depreciation for tax purposes in any year or years of his choice—he can claim even 100% depreciation in the very first year. Even under the Labour Government with a strong socialist bent, British industry was allowed this liberal scheme of claiming depreciation.

Mr. William Miller, Chairman of the Federal Reserve Bank of the United States, has observed: "There are various ways to stimulate investment, but you get the biggest bang for the buck with faster depreciation."

Many plants in our country are getting worn out, but the deterrent to replacement is that, over the last 12 years, the cost of capital equipment has risen four to seven times in almost every major industry. Instead of increasing the normal depreciation by 50% in the first year, the Finance Minister might well consider adopting the recommendation of the Sachar Committee that companies should be required to set aside a percentage of their profits as a replacement reserve, which should be allowed as a deduction in computing the taxable income.

A nation which will not let its industry retain sufficient funds to provide for obsolescence will itself soon become obsolescent.

There is no fiscal incentive in the Budget to promote exports. On the contrary, sections 35-B and 80-O of the Income-tax Act which deal with foreign earnings have been drastically amended to the detriment of the taxpayer. We are living in times when a big spurt in exports is an imperative of our economic viability. The cost of imported oil and petroleum products will be Rs 5,000 crores (48% of the import bill of Rs 10,300 crores) in the current year. The foreign trade deficit was Rs 2,232 crores last year and will be higher this year. While India is the fourth largest producer of foodgrains and the tenth largest manufacturer of industrial products, it has only 0.5% of the world export market. One of the principal reasons for our poor export performance is the maddening instability of our laws regarding taxes and export subsidies.

Economy in governmental expenditure

In sum, while the Budget contains indubitable elements of good, it is a fraction of the Budget we have been waiting for.

The Budget does not give any indication of the vaguest consciousness, on the part of the various Central Ministries, of the desperate need to ensure economy in public expenditure. When the late Mr. H. V. R. Iengar presided over my Budget talk in Bombay a few years ago, he remarked that his experience of 40 years in government had convinced him that, generally, about 40% of Government expenditure went down the drain. This estimate is strikingly corroborated by the experience of a distinguished official in Britain. Mr. Leslie Chapman, an ex-civil servant, has published an interesting book with the appropriate title, *Your Disobedient Servant*, where he narrates the story of Whitehall's overspending. He shows that an immediate saving of about 30% of the total maintenance expenditure and of 40 to 50% of the directly employed labour could be made.

There are no less than 8.8 million employees of the Central and State Governments who are merely concerned with administration, as against 7.2 million employees in organised industry in the private sector. Economic stagnation is the inevitable consequence of such disproportion between productive and unproductive jobs. There should be a total ban for five years on fresh recruitment in the administration section of the Central and State Governments. This would mean that, if 2%of the Government employees retire in a year, in five years' time the Government staff would be reduced by about 10%—a factor which would be conducive not only to economy but, more importantly, to efficiency of administration.

The shroud of secrecy

Personally, I have great regard and esteem for Mr. R. Venkataraman whose exceptional competence to hold the finance portfolio is beyond the pale of controversy. But the reason why he has been induced to accept some grossly unfair changes is the infernal shroud of secrecy which envelops every budget. We have inherited this tradition of outdated secrecy about the budget from Britain where also the system has been strongly attacked by eminent economists and political scientists including Peter Jay.

Mr. Patrick Lenkin, who has vast and first-hand experience of Finance Bills in the British Parliament, says:

"The way in which we legislate our changes in our tax laws does this House and the system we operate little credit. . . . Let us not delude ourselves: when we think that we are doing rather well on some complicated Finance Bill Clause, plenty of people outside are completely convinced that we have missed many of the main points—and they are probably right . . . . We must have less secrecy and more consultation; but, above all, we must have an opportunity for Hon Members to hear at first hand evidence from the real protagonists in much of this legislation—the revenue on the one side and the professions on the other—as to the issues and merits of the legislation which we are considering."

Mr. Patrick Lenkin is one of the large number of thinkers in Britain who are strongly advocating that the old secrecy surrounding budgets must go and that budget proposals must be openly debated in public before they are introduced in Parliament.

Sir Richard Clarke, who was the originating genius of nearly every important development in the British budgeting techniques during the last two decades, has spoken out about the abuse of budget secrecy:

"The problems of long-term tax policy should surely be debated openly with the facts on the table . . . . 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 . . . . Indeed, this obligation to publish taxation policy is really essential for the control of public expenditure. In order to get realistic expenditure decisions, governments must argue them, both within themselves and outside, against their taxation implications."

Realizing that democracy flourishes best on the principle of open government, more and more democracies are having an open public debate on budget proposals before introducing the appropriate Bill in the legislature. In the United States the budget is conveyed in a message by the President to the Congress, which comes well in advance of the date when the Bill is introduced in the Congress. In Finland, the Parliament and the people are already discussing in June 1980 the tentative budget proposals which are to be introduced in the Finnish Parliament in September.

Mr. Venkataraman is the man of right calibre and courage to make the momentous innovation of scrapping the shroud of secrecy and inviting an open debate before introducing his Budget next year.

Every budget contains a cartload of figures in black and white — but the stark figures represent the myriad lights and shades of India's life, the contrasting tones of poverty and wealth, and of bread so dear and flesh and blood so cheap, the deep tints of adventure and enterprise and man's ageless struggle for a brighter morn. The Union budget should not be an annual scourge but should partake of the presentation of annual accounts of a partnership between the Government and the people.

That partnership would work much better when the nonsensical secrecy is replaced by openness and public consultations, resulting in fair laws and the people's acceptance of their moral duty to pay.

(Based upon the public talk in Bombay on 21st June 1980, the M. Ct. M. Chidambaram Chettyar Memorial Lecture in Madras on 28th June 1980, the talk under the auspices of the Federation of Karnataka Chambers of Commerce & Industry in Bangalore on 29th June 1980, and the articles which appeared in the Times of India and the Illustrated Weekly of India)

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