THE UNION BUDGET 1990-91

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The *Kaliyug* Clock and the Rain Dance

By

Nani A. Palkhivala*

Professor Madhu Dandavate, the Finance Minister, belongs to a rare species in India's public life. He has a well-equipped and well-furnished mind — in contrast to the overwhelming majority of our politicians, of whom it may be said that their minds are some of the under-developed regions of the States they represent.

Throughout his public life, Professor Dandavate has proved himself to be totally dedicated to national good: he is concerned not so much with public relations as with public principles. His receptivity, integrity and sincerity are beyond question. The goals he has set out for the nation in his Budget Speech are unexceptionable.

The Budget which he has introduced in Parliament is that of an honest humanist. It is not a Budget to make you deliriously happy or to drive you to the verge of suicidal despair. It may be regarded as a good Budget in bad times, though it might have ranked as a bad Budget in good times.

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*Mr. Palkhivala is the President of the Forum of Free Enterprise. The text is based upon the public talk in Bombay on 23rd March, 1990, and subsequently in Calcutta, Madras, Bangalore, Delhi, Hyderabad, Pune and Ahmedabad.

Backdrop to the Budget

I. *National indebtedness.* **The darkest shadow brooding over the national economy is that of the national indebtedness. There has been an unbridled increase in the total liabilities of the Government, which include not only what is narrowly and misleadingly called "the national debt", but also the liabilities to repay to the citizens the amounts due to them on account of provident fund, small savings, etc. The net liabilities of the Central Government aggregate to Rs. 260,000 crore, while the interest burden amounts to Rs. 17,000 crore annually.**

The national indebtedness will increase further in the next twelve months by Rs. 40,000 crore: there would be a net increase of Rs. 36,629 crore in the internal debt, and an addition of Rs. 3,334 crore to the external debt. The total burden of interest will then aggregate to Rs. 20,850 crore, i.e. 22 per cent of the total Government expenditure of Rs. 94,535 crore budgeted for the next twelve months. The terms on which the Government will borrow are also hardening. On the additional borrowings the Government will be paying average interest at 10.1 per cent as against 7.8 per cent last year.

This is the greatest of dangers to be feared. It puts the nation at risk. We are stealing from the future. The interest and repayment burdens will have to be shouldered by our children and will have to be discharged by taxation on them. For years to come, the dead hand of the excessive national debt will continue to rest heavily upon the productive energies of the country. The Government is already expending a larger amount on servicing the loans than it spends on Plan or defence.

The figures are so mind-boggling that it is desirable to have comparative figures of an affluent nation, — which may afford a measure of our own Government's extravagance. Taking all relevant factors into account it would be fair to say that a dollar is to the United States what a rupee is to India. The debt of the United States Government increases at the rate of $ 8,000 per second, — to the American public's great dismay and concern. The indebtedness of the Indian Government increases at the rate of Rs. 11,000 per second. The inescapable conclusion is that India's public debt increases 40 per cent faster than that of the United States.

In order to arouse public sentiment against the grave financial crisis, I suggest that we have a KALIYUG CLOCK in different parts of India to indicate each day the figure of national indebtedness which is mounting at the rate of Rs. 110 crore a day. Every day in every way India goes another Rs. 110 crore into debt.

Article 292 of the Constitution enables Parliament to prescribe by law the limits within which the executive can borrow upon the security of the Consolidated Fund of India. The time has come for Parliament to prescribe such a check. The fixing of ceiling on the borrowing power of the Union Government was suggested by the Chakravarty Committee appointed to review the working of the monetary system. It was also recommended by the Public Accounts Committees in their Ninth Report (1962-63), Thirty-Sixth Report (1964-65), Fifty-Second Report (1965-66), and Sixty-Fourth Report (1968-69). The Comptroller and Auditor-General made the same recommendation in his Report published in 1988.

The people must bring strong and sustained pressure on their MPs to ensure that curbs on borrowing powers are fixed by Parliament. The good sense of the government has proved to be a non-existent substitute for legal compulsion.

The Finance Minister deserves the nation's gratitude for his public pronouncement that he would not be averse to an appropriate law being passed by Parliament under Article 292.

II. *Deficit on revenue account.* For the last ten years the Government has been living beyond its means and beyond your means and mine. The result is the deficit on revenue account which was unknown during the first thirty years of our existence as a republic. During the last decade, the deficit on revenue account has roared out of control.

This year's Budget itself provides for a revenue account deficit of Rs. 13,032 crore. It is sought to be reduced to the overall deficit of Rs. 7,206 crore by transferring Rs. 5,826 crore from capital account (i.e. from borrowings). Such a transfer is the highest ever proposed to be made in our history.

As a compulsive borrower, the Government has no qualms. It has been extraordinarily careless about containing its expenditure. It seems to have no notion that a hundred crore here and a hundred crore there adds up to real money.

III. *Foreign exchange resources.* While the national indebtedness in foreign exchange exceeds US $ 60 million, our foreign exchange reserves are only equivalent to Rs. 5,000 crore. Even this paltry figure of reserves is reached after taking into account the balances to the credit of Non-resident Indians (NRI)

who have deposited Rs. 17,000 crore in their bank accounts which they are entitled to withdraw in foreign exchange. Ten years ago our foreign exchange reserves were three times the deposits in NRI bank accounts. Today, the NRI deposits are more than three times the foreign exchange reserves.

The export drive can never succeed so long as we continue the maddening instability in our Export-Import Policy and in the tax structure affecting exports.

After the *Stable* Export-Import Policy was announced in April 1985, hundreds of changes were made in it in the next three years. The average came to one change almost every alternate working day.

A new *Stable* Export-Import Policy for three years was announced in April 1988. Till the middle of March 1990, there had been 210 Notifications amending the Import Policy and 79 Notifications amending the Export Policy, — which again works out to one change every alternate working day.

Is it surprising that India's performance on the export front is so dismal compared to its potential? World trade is a race in which India has to run in a potato sack, while other countries compete with no such handicap. In 1950 our exports were substantially higher than those of Brazil and South Korea. Today the exports of Brazil are three times, and those of South Korea are five times, larger than India's. India's share has dropped from 2.2 per cent of world trade in 1950 to less than half of one per cent (0.45 per cent) at the latest reckoning. Among the exporting countries our rank which was sixteenth in 1950, has dropped to forty-third.

As the Chancellor of the Exchequer pointed out in the House of Commons a few years ago, Hong

Kong has twice the international trade of India, although its population is less than one per cent of India's—0.7 per cent to be precise—while its land area is 0.03 per cent of India's.

IV. *The public sector.* **The sleeping sickness of socialism is now universally acknowledged. The total capital invested in the 231 enterprises of the Union Government is Rs. 71,299 crore. In the 636 public sector enterprises run by the State Governments, the total amount invested is Rs. 25,000 crore. (This figure is of March 1986. Such is the inefficiency of public administration in our country that the total figure of capital invested in the public enterprises run by the States has not been updated for the last four years.)**

These public sector enterprises are the black holes, the money guzzlers, and they have been extracting an exorbitant price for India's doctrinaire socialism.

The Finance Minister has shown pragmatism by announcing his intention of inviting the employees in the public sector to hold shares in the capital of the enterprise they serve. It is to be hoped that this will be the first step towards privatization which is the wave sweeping across the world from Thailand to Turkey and from Brazil to Bangla Desh.

V. *Black money.* **The Finance Minister should have total public support in his endeavour to "launch a sustained and multi-pronged drive against proliferation of black money which is a social sin and an economic evil". However, what is wrong with India is the pathological obsession displayed by the law-makers who frame laws only with the tax evader in mind, regardless of the enormous inconvenience and harassment to the far larger section of honest taxpayers. It needs to be borne in mind that 96 per cent of all direct taxes**

collected by the Union Government is on the basis of voluntary self-compliance by the taxpaying public. Only four per cent of the collection is involved in unending appeals to the tax authorities and references in the Court of law.

Under-estimation of income is a worldwide phenomenon. India has a lot to learn from other countries where the laws operate fairly and reasonably on honest taxpayers and are not framed with excessive and obsessive concentration on the tax evader.

The latest investigation in the United Kingdom of corporate taxpayers showed that the income disclosed by 91 per cent of them was under-estimated. The European Economic Community estimates that at least ten per cent of the income earned in its member countries escapes tax. In Japan, an examination made by the revenue in 1988 of the accounts of 2,206 companies showed that all but one had under-estimated their income!

The phenomenon is not peculiar to free societies but is discernible even in totalitarian countries where the penalty for several economic offences is death. Last year, the communist regime in China seized the books of registered businessmen of Shanghai and found that 86 per cent of them had returned income which needed to be adjusted upwards! In the Soviet Union, the "unofficial sector" flourishes no less stridently than in India.

In these matters one must have a balanced approach and a sense of proportion. A departmental store which is wholly preoccupied with prevention of shoplifting is a sure candidate for stagnation.

Tax on the Corporate Sector

The reduction of tax on the corporate sector from 50 to 40 per cent (43.2 per cent if surcharge is taken into account) is a very welcome feature. All over the world, reduction of corporate tax is now used as the instrument of economic growth. Sweden has decided to reduce it from 57 to 30 per cent, and in Japan it will now be 37.5 per cent. Singapore has reduced it (in the Budget presented in March 1990) to 31 per cent. The rate of 35 per cent prevails in the UK, the Netherlands, Portugal and Spain.

A step in the right direction is the total exemption of intercorporate dividends under Section 80M of the Income-tax Act — but subject to the condition that intercorporate dividends would be entitled to exemption only if the company receiving the dividend declares an equal amount by way of dividend to its own shareholders. The Budget should have abolished, or in any event substantially reduced, the tax on dividends which are paid out of profits on which the company has already paid tax, even where the shareholder is a non-corporate entity, e.g. an individual. Such a system prevails in a large number of countries, including the UK, France, Germany and Japan. In Pakistan, all shareholders are exempt from tax in respect of all dividend income. Public interest demands that we enlarge "the democracy of shareholders", instead of increasing the holdings of the public financial institutions in the private sector.

The abolition of investment allowance is a retrograde step. *Investment allowance is investment by the government in national growth.* **Developing countries find it indispensable. Pakistan allows a deduction of 40 per cent above the cost as an investment incentive, Malaysia 60 per cent, while in Korea the incentive is as high as 100 per cent.**

In the Memorandum explaining the provisions of the Finance Bill, 1990, the abolition of reliefs under Sections 32A, 32AB, 33A, 80HH, and 80HHA of the Income-tax Act is grouped under the sub-title *"Streamlining of the tax structure".* **This heading is misleading and amounts to misuse of language. The correct heading should be —** *"Steamrolling of tax reliefs".*

One of the most welcome features of the Budget is the proposed abolition of Section 115J of the Income-tax Act. That section was patently an intruder in the Act. It penalized companies which are really the dynamic enterprises in our corporate sector. They undertake plans of development and expansion which result in capital formation, productive investment, increased employment and larger revenues for the Union and the States by way of customs, excise, sales tax, etc. The section made "no-tax companies" liable to tax only because they showed a book profit in their profit and loss account submitted to the shareholders. That whimsical provision should never be resuscitated again.

Personal Taxation

One of the most gratifying features of this year's Budget is the decision to abolish gold control. This 27-year old control has long outlived its utility. Today it only breeds dishonesty, corruption and public disrespect for the law. It deserves to be universally condemned. The Gold Control Act itself has not been repealed but only the decision to abolish it has been announced. Public vigilance is required to ensure that vested interests do not try to scuttle the decision as is being done in the case of octroi. After gold

control is abolished, it would be pre-eminently in the public interest to allow each tourist to bring, say 100 g. of gold on payment of reasonable custom's duty.

The threshold of chargeability to income-tax is sought to be increased from Rs. 18,000 to Rs. 22,000. It should have been increased to at least Rs. 30,000. The minimum taxable limit of Rs. 15,000 was fixed in 1981, and that corresponds to Rs. 32,000 today; while the limit of Rs. 18,000 (fixed by Shri V. P. Singh in 1985) is equivalent to about Rs. 27,000 today.

The proposal to replace deductions from total income under Section 80C by a rebate in tax is a retrograde step. It puts the clock back by 23 years. It is typical of the way in which our laws are chopped and changed without any reference to, or knowledge of, past history.

The truth of the matter is that what is now put forth as a new scheme prevailed for many years in the past under our income-tax law. In 1967 after full consideration, the Government decided to switch over from the scheme of rebate in tax to the scheme of deductions from income under the present Section 80C. The Bhoothalingam Committee's Report, 1967, sets out lucidly and cogently the reasons for the switchover. It will create totally unnecessary confusion to retrace our steps again.

A characteristic example of what I have called the lawmaker's pathological obsession with tax evasion is provided by the new Section 80DD which grants a deduction to an assessee in respect of expenditure actually incurred by him on medical treatment for rehabilitation of a handicapped relative.

The ceiling on the allowance is only Rs. 6,000, which is further to be reduced by any income of the handicapped relative. The ridiculous length to which the draftsman goes to safeguard against tax evasion is almost beyond belief. While the section itself stipulates that the permanent physical disability (including mental retardation) must be such that it has "the effect of reducing considerably such person's capacity for normal work", it is further sought to be provided that the handicap should be such as is "specified in the rules made in this behalf by the Board" and should be further certified by "a physician, a surgeon, an oculist or a psychiatrist . . . working in a government hospital or a government dispensary", and that the relative should be *not dependent on any person other than the assessee* for his support or maintenance. The absurd result is that if a handicapped parent is supported by his two children, neither of the two children would be entitled to any deduction under the section. Such inane legal litter only serves to clutter up the statute book. Did it never cross the mind of the law-maker that an assessee so dishonest and heartless as to be capable of cooking up a false case of expenditure on a handicapped relative would prefer to conceal income of Rs. 6,000 rather than disclose his true income and then make a dicey claim for a deduction?

Breach of Faith

The Union Budget should not be a scourge but should partake more of the nature of the presentation of annual accounts of a partnership between the government and the people. In the presentation of such annual accounts, good faith and a sense of honour are essential if the partners are to have confidence in each other.

One of the most disturbing trends in recent Indian history is the total lack of good faith and of a sense of honour on the part of the administration.

In the last twenty-five years flagrant breaches of promises and guarantees have been perpetrated by government and public authorities all over India. State Electricity Boards promise exemption from electricity duty for a specified period to attract industries to backward areas, even as municipalities promise exemption from octroi to entice new industries to their region, and then go back on their written assurance. Our standards of public behaviour have become so degraded and depraved that such tactics are openly adopted without the slightest fear of public outrage.

The fiscal system must have not merely legality but also legitimacy. It is denuded of all legitimacy when there are breaches of faith on the part of the government in its dealings with taxpayers.

When the government violates the law of its own making, how can it expect citizens to respect the law? The Finance Act of 1986 abolished investment allowance without three years' notice, despite the express provision in the law that investment allowance would not be abolished without such notice.

Investment allowance was reintroduced only last year. Further, it was only last year that saw the introduction of the scheme under which the assessee had to opt between investment allowance (under Section 32A) and investment deposit account (under Section 32AB) — which option once exercised was to enure for a period of five years. This raised a legitimate expectation in the public mind that the

reliefs are to continue for at least a period of five years. Without any prior notice, now both the sections are sought to be rendered inoperative.

A similar breach of faith is involved in the abolition of reliefs under Section 33A (development allowance for tea bushes planted in new fields); Section 80HH (establishment of new industrial undertakings or hotels in, or shifting of existing units from cities to, backward areas); and Section 80HHA (establishment of small-scale industrial undertakings in rural areas). The Finance Bill seeks to give a peremptory notice of twelve days that the planting should be completed, industrial production should begin, or the hotel should start functioning, by 31st March 1990! The aforesaid sections have been in operation for a long time — ranging from 13 to 25 years. What would happen to the schemes which are in the process of implementation and which were undertaken by trusting taxpayers who are suddenly told that they will be denied the relief without any default on their part?

The Misery Index

The Budget is not likely to have any salutary effect on the Misery Index, i.e. the index covering inflation, poverty and unemployment. There can be no doubt that with the cascading effect of increased levies, inflation would be higher in the next twelve months than in the past twelve.

It cannot be too often emphasized that India is not poor by nature but poor by policy. Today we are still the twenty-first poorest nation on earth. Between 1950 and 1989 India's per capita income in real terms did not even double but increased by only

91 per cent. We have 15.5 per cent of the world's population but only 1.5 per cent of its income.

In 1950 India had an average income higher than that of Thailand or South Korea. Today, Thais have an average income of $ 900 a year, and South Koreans $ 2,370. Indians languish on $ 290. Our bureaucratic over-planning, which has entrenched poverty, is no cause for pride.

As at 31st December 1987, the Reserve Bank of India identified 2,06,098 units—large, medium, and small-scale—as sick. Since such sick units are increasing at the rate of 188 every working day, there must be at least three lakh sick units today, and 93 per cent of them are terminally ill.

The number of persons seeking employment through the 840 Employment Exchanges is rising at an alarming rate. It exceeded 30 million at the end of 1988; while the actual strength of the army of the unemployed must be double that figure.

The aggregate number of persons in the organized sector is 26 million. Here the organized sector means (a) the private sector employing more than 25 persons, and also (b) the public sector, i.e. the Union and State governments, municipalities, local authorities and public sector corporations. Thus, for every one person employed in the organized sector, there are two who are jobless!

Futurologists all over the world are predicting that the countries of Asia will be the economic powerhouses of the future. There is a scramble to board the Orient Express to the twenty-first century which is less than 3,600 days away. But there is not an uncontrollable rush to enter India.

The total foreign investment of Rs. 3,000 crore in India over the last forty years is less than the *annual* investment made in China or Australia in recent years. This year's Budget will not dispel our socialist stagnation.

In several parts of Africa when the rains do not come, the tribal chief conducts a ritual dance watched by the anxious members of the tribe. The dance does not bring rains, but it consoles and satisfies the people who feel that their chief is doing something to alleviate their misery. Our feverish changes in the law are intended to serve the same purpose as the tribal chief's rain dance.

Accent on Human Development

History will record that the greatest mistake of the Indian republic in the first forty years of its existence was to give abysmally low priority to education — in fact no priority at all.

In the Budget, the total expenditure allocated for education, Plan and Non-Plan, is Rs. 1,588 crore, i.e. less than two per cent of the total government expenditure of Rs. 94,535 crore, and less than half of one per cent of our present gross domestic product of more than Rs. 440,000 crore.

The World Bank has estimated that by the turn of the century 54 per cent of all illiterates will be in India. But there is no change in our nonchalant attitude towards education.

Family planning is no less important to improve the quality of Indian life. This year the aggregate of Plan and Non-Plan expenditure on family planning is budgeted at Rs. 685 crore — less than one per cent

of the total government expenditure and less than a quarter of one per cent of our gross domestic product. We leave untouched the most daunting problem facing the nation — the frightening increases in population.

At a recent meeting of the World Economic Forum at Davos, Prime Minister Lee Kuan Yew of Singapore said to a leading Indian businessman: "The Indian economy is like a sleeping giant which, if awakened, could by itself transform the face of the global economy. India has the potential to form an independent economic block on her own, without too much dependence on anybody else". But in keeping with our forty-year hallowed tradition, the Budget this year will not be so rude as to disturb the slumber of the sleeping giant.

52-1

Have you joined the Forum?

The Forum of Free Enterprise is a non-political and non-partisan organisation, started in 1956, to educate public opinion in India on free enterprise and its close relationship with the democratic way of life. The Forum seeks to stimulate public thinking on vital economic problems of the day through booklets and leaflets, meetings, essay competitions, and other means as befit a democratic society.

Membership is open to all who agree with the Manifesto of the Forum. Annual membership fee is Rs. 50/- (entrance fee, Rs. 50/-) and Associate Membership fee, Rs. 20/- (entrance fee Rs. 10/-). Graduate course students can get our booklets and leaflets by becoming Student Associates on payment of Rs. 5/- only. (No entrance fee).

Write for further particulars to the Secretary, Forum of Free Enterprise, 235, Dr. Dadabhai Naoroji Road, Post Box No. 209, Bombay-400 001.

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