THE UNION BUDGET 1993-94

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By

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The adverse comments on the Budget have been largely motivated by vested interests, considerations of party politics and dictates of ideology. The general reaction of the stock markets has been unfavourable; but a hostile reaction on the bourse may turn out to be for the benefit of our country. By and large, the market value of equity shares is already too high: the Profit Earning ratio is much higher in India than in the UK and the USA where it ranges between 15 and 20 times. (As you know, the Profit Earning ratio is arrived at by taking the market value of the share and dividing it by the net after-tax earning per share of a company.) The excessive prices on our stock exchanges have acted as a deterrent to foreign investment.

On the whole, it is a creative and nutritive Budget. Dr. Manmohan Singh is not a politician but a technocrat. He has introduced a Budget which a mere politician would have thought possible only through witchcraft or fraud, to use the words of *The Economist.*

The goals of the Budget are unexceptionable. Agriculture and agro-processing industries are

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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 3rd March, 1993, and subsequently in Calcutta, Ahmedabad, Delhi, Pune, Hyderabad, Madras, Bangalore, Muscat and Dubai.

sought to be promoted. Another avowed objective is to promote exports. When you realize that Holland with a population of only 15 million, has six times the exports of India, and the city of Hong Kong has almost three times the international trade of India, you appreciate that we have a long way to go.

The third objective of the Budget is to curb inflation and to reduce deficit financing. Inflation which was 17 per cent in August 1991 has already been reduced to 7 per cent. Fiscal deficit, which had risen to 8.4 per cent of the gross domestic product, is now only about 5 per cent. The unborn generations are a group wholly unrepresented in Parliament, and to protect their vital interests it is essential that we bear the burden of our own debts. In the words of Thomas Jefferson, one of the outstanding Presidents of the USA, "The question whether one generation has the right to bind another by the deficit it imposes is a question of such consequence as to place it among the fundamental principles of government. We should consider ourselves unauthorised to saddle posterity with our debts, and morally bound to pay them ourselves."

Accent on education

The fourth goal is to increase expenditure on development—health, education, and family planning. It is development which determines the quality of life. The riots and disturbances which recently took place at Ayodhya, Bombay and Surat were the handiwork of hoodlums who made Hitler look like a juvenile delinquent. A long-term plan of value-based education alone can prevent the recurrence of such disasters. Our concept of freedom will remain an impoverished one until it is rounded and deepened by value-based education. Till then we shall continue to work a third-class democracy under a first-class Constitution.

It is for the first time that an Indian Budget has emphasized the need for education. After 45 years of independence India has begun to realize that education is the rock on which we must build our political salvation. Our country will be built not on bricks but on brains; not on cement but on enlightenment. If we cannot afford education, we cannot afford to remain a civilized society. Dr. Manmohan Singh realizes that we must invest in people, and that human capital is the most precious form of capital there is. The recent United Nations Development Report ranks nations of the world by reference to the Human Development Index (HDI). India continues to be placed pretty low—121st out of 160 countries.

Revival of the economy is another important goal. The gross domestic product of our country is smaller than that of Greater Los Angeles. Even the countries whose currency was weaker than India's for decades have marched ahead. Today 52 Mauritian rupees and 79 Pakistan rupees equal 100 Indian rupees.

The sixth and last goal—of tax reform, remains a distant dream so far as direct taxation is concerned. It is only in the field of indirect taxes that positive measures have been taken.

Measures to achieve the six goals

The measures sought to be adopted to achieve the six goals are well conceived. The minimum rate at which banks will lend has been lowered and, even more importantly, the statutory liquidity ratio which is 36 per cent today is planned to be reduced to 25 per cent over the next three years. This means that larger funds from the banking sector would now be available for economic development. The rupee has been made fully convertible. The Central Plan Outlay will be increased from Rs. 48,407 crores to Rs. 63,936 crores. It is proposed to increase the disbursements on agriculture by 36 per cent, on education by 37.6 per cent, and on health by 60 per cent.

The lower rates of duties of customs and excise should help the economy. It is a matter of regret that excise on cement has not been reduced. Excise revenues from cement amount to about Rs. 2000 crores—roughly the same amount that the government gets from cigarettes. It can hardly be suggested that cement is as injurious to the economic health of the country as cigarettes are to the health of the smoker!

The amendments to the Income-tax Act, 1961 are well conceived. It is proposed to grant a tax holiday under Section 10A to new software and hardware enterprises. There would be a deduction of 125 per cent, under Section 35, in respect of contributions to a National Laboratory. Under Section 80HHE, the exemption for software exports is continued for one more year. Under

Section 80G, full deduction would be available in respect of donations to approved universities and institutes of technology or management. The proposed amendment to Section 80-IA will grant a tax holiday to any new industrial undertaking in the specified sixteen States and Union Territories and to any new undertaking in any part of India for generation or distribution of electricity.

Recent world trends

The Budget is in conformity with recent trends the world over. Fashions in ideas change, as do fashions in clothes. India is much less quick to follow new fashions in ideas than in dress.

It has been observed that nationalization was the fashion in the 1940s, as was privatization in the 1980s. Luckily, education has become all the rage in the 1990s. World opinion is veering round to the view that education is the universal panacea of the day. Dr. Warren Bennis, the guru of business management, said that what is needed for our competitive advantage, long-range growth and full deployment of our people are three things: education, education, and education.

Liberalization and lower taxes are again in vogue. John Smith, the new leader of the Labour Party in Britain, said last month that if his party were elected there would be no nationalization, no high taxes and no enhancement of union power. He called it "economic madness" to raise taxes and added that such an increase would be a "massive betrayal". Less than a week before our Budget was introduced in Parliament, Singapore reduced corporate tax from 30 to 27 per cent, and the rate of top personal tax from 33 to 30 per cent.

The shortcomings of the Budget

The shortcomings of the Budget are as obvious as its plus points. The failure to increase the threshold for personal taxation cannot be justified on any ground. The minimum income liable to personal tax remains unchanged at Rs. 28,000.

The minimum taxable limit was fixed in 1981 at Rs. 15,000 which is equivalent to Rs. 45,000 today. In 1985 it was raised to Rs. 18,000 which is equivalent to Rs. 37,000 today. In 1990 it was raised to Rs. 22,000 and in 1992 to Rs. 28,000 —both those limits would be equivalent to Rs. 31,000 today. In order to take care of the unfolding future and to eliminate the necessity of annual revision, the limit should be raised to at least Rs. 45,000. In Pakistan the threshold is Rs. 40,000 (equivalent to Indian Rs. 50,400) and the tax at that level is only 10 per cent.

No attempt whatever has been made to achieve stability or simplicity in our tax laws. I should like to repeat the suggestion I had made earlier that there should be a separate Minister for Stability and Simplicity whose only duty would be to ensure that these two great virtues of any good government are preserved and promoted. He should be accountable only to the Prime Minister and his word should prevail.

The surcharge of 12 per cent on the income-tax payable by individuals, and of 15 per cent in the case of companies, should have been abolished, as had been promised last year.

Paucity of foreign investments

The general public are not even aware that the greatest single factor responsible for the paucity of foreign investments in India is the insensate instability of our laws, specially tax laws, and the total absence of honour and good faith on the part of the government. This is the most vital of all the points I shall touch upon.

The number of Non-Resident Indians (NRIs) residing abroad would be close today to 15 million. Their accumulated wealth, at a conservative estimate, would be not less than 100 billion in US dollars, the equivalent of Rs. 312,000 crores.

A week after the Budget was introduced in Parliament, I visited Muscat and Dubai to speak on the Budget and to persuade NRIs to invest in India. I pointed out the benefits of further liberalization and the new tax concessions which afford attractive incentives to invest in new enterprises. The general impression I gathered was that NRIs are not only willing but eager to help India. Their strong emotional attachment to their motherland is beyond question. They find the policy of liberalization sufficiently attractive and the tax reliefs in this year's Budget sufficiently generous.

But the most perturbing part of their reaction was their mistrust of the government, born of their bitter experience of the maddening changes in Indian laws and their painful consciousness that the law permits what honour forbids. They bluntly ask—can we trust the Government of India? If they start an undertaking on the strength of the tax holidays proposed in this year's budget, can they be sure that the basis on which they decide to embark on the venture will continue to be the law of India at the time when production commences three years later? The majority of chartered accountants practising in the Middle East are NRIs themselves and they have full knowledge of what has been happening in the recent past.

Prior to the Finance Act 1986, the then existing Section 32A(8) of the Income-tax Act provided that the Central Government might notify the discontinuance of investment allowance in respect of any ship or aircraft acquired or any machinery or plant installed after a specified date "not being earlier than three years from the date of such notification". The Finance Act 1986 shamelessly discontinued investment allowance without the three years' notice which was mandatory under the law, by the simple expedient of omitting the statutory words which required three years' notice. The force of high-handedness could go no further. Indians have no option but to submit to such strident injustice. But NRIs and other foreigners who can venture in any part of the world are understandably averse to investing in a country where a sense of honour has become totally anachronistic.

In a profound sense, the issue of abolition of investment allowance without the statutory notice involved the honour of the government and of Parliament. The tax evader breaks the law. The government which abolishes investment allowance without three years' notice equally breaks the law. Does it make a difference that the government has the power to pass an amendment which is the fig leaf to cover up the flagrant breach of faith? Is there much to choose between a tax-evading citizen and a promise-evading government?

Incidentally, in the last twenty-five years, brazen breaches of promise have been perpetrated by governments 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 industrial undertakings 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 belief that the government will act on principles of honour and good faith is an invaluable but fragile national asset. The greatest mistake men in power make is to destroy that asset at their arrogant whim and fancy. 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.

A similar breach of faith was involved in the abolition of reliefs by the Finance Act 1990 which dealt with certain provisions of the Income-tax Act. It abolished, without notice, 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). Those sections had been in operation for a long time—ranging from 13 to 25 years. The government refused to consider the palpable injustice entailed as regards schemes which had been in the process of implementation and which had been undertaken by trusting taxpayers on the basis of existing law.

Not surprisingly, the total NRI direct investment during the period 1975 to 1992 has amounted to a meagre Rs. 582 crores (or 188 million dollars at the current rate of Rs. 31 per dollar). This was only ten per cent of the total foreign investment in India during those years. In the case of other foreigners who have no ties with India, the erosion of international confidence, resulting from the mindless instability of our governmental policy, acts as even a greater deterrent to investment in India. In the year 1992, approvals for direct foreign investment in India amounted to only 1.25 billion dollars, as against ten billion dollars in China, six billion dollars in Mexico, three billion dollars in Malaysia, and 1.8 billion dollars even in small Thailand.

The question may be asked—how can any finance minister ensure that such breaches of faith are not committed by his successors? In Mauritius they amended the Constitution and provided that any changes in certain policies could not be made without a special majority needed to amend the Constitution. India need not go to that length. There is a simple expedient to deal with the situation. The government should declare its economic and fiscal policy for the remaining term of its office. It should apologize for the breaches of faith committed in the past and publicly avow that its policy hereafter would be to ensure that those who act on the faith of the existing law would be protected. Such a solemn assurance would give rise to the doctrine of "promissory estoppel" which, in jurisprudence, means that the government is estopped from going back on its promises. The equity of promissory estoppel can be enforced in the High Courts and in the Supreme Court by any aggrieved citizen or foreigner.

This is the only way of attracting large foreign investment. Otherwise, in the prevailing atmosphere of fully justified mistrust of the government, which NRI or other foreigner will invest on the basis of the proposed amendment of Section 10A of the Income-tax Act which promises a tax holiday to a new industrial undertaking for production of hardware or software in technology parks, or of Section 80-IA which promises a tax holiday to any industry started in the sixteen specified areas and to any undertaking which generates or produces electricity in any part of the country?

Let us never forget that large countries and small minds go ill together, and that absence of a sense of honour can never be compensated by politicians however able or by bureaucrats however astute. We Indians are a low-arousal people, but even we should be stung by shame in committing a breach of faith by changing our laws to the detriment of those who act on the basis of our existing enactments.

To sum up, on the whole, the Budget is a harbinger of good times to come. It will not take India to heaven but it will check India's precipitate slide to hell.

556

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