UNION BUDGET 1989-90 PROVIDES NO REMEDIES FOR ECONOMIC ILLS

by

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"Free Enterprise was born with man and shall survive as long as man survives."

— **A. D. Shroff**
1899-1965
Founder-President
Forum of Free Enterprise

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The best that can be said about the budget presented on 28th February, 1989, is that no adverse provision has been made which will hamper economic growth. However, a lot could have been done to give an effective impetus to industrial activity, thereby widening the productive base.

The Finance Minister, Mr. S. B. Chavan, in an election year, can be forgiven for adopting the strategy of offering bouquets to the poor and brick-bats to the rich. However, what cannot be forgiven is that he has totally ignored the needs of the industrial sector which contributes almost 80% of the revenues of the Government.

The budget exercise will leave untouched the two major problems of restoring the fiscal imbalance and the widening trade-gap which has brought down our foreign exchange reserves to precarious levels. The advice given in the Economic Survey of 1988-89 goes unheeded and the remedies prescribed have largely been ignored by the framers of the budget.

The most important message given in the Economic Survey presented four days before the Budget, was that the Government should curb the growth of current non-plan expenditure. It was expressly suggested that this could be achieved by eschewing all wasteful and low priority schemes and limiting the quantum of subsidies.

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No attempt has been made in this direction by the Finance Minister.

The budgetary deficit estimated for 1989-90 is Rs. 7,337 crores, which is more or less at the same level as the expected deficit during the current year. Thus, the hope that the deficit would be pruned has been belied and, therefore, no serious step has been taken to contain inflation which has been howering around 9% even after a record increase in food grain production has been registered.

The Government's emphasis on poverty alleviation scheme will have a marginal impact on the rural poor and schemes for generating more employment opportunities will only scratch the surface of the problem. The additional revenue of Rs. 500 crores sought to be raised by levying a 8% surcharge on the income of the middle class and the affluent, will result in creating a few more million mandays of employment.

According to the Finance Minister, during the current year, the two rural employment schemes resulted in the creation of 670 million mandays of employment and, therefore, with the additional outlay of Rs. 500 crores, it is possible that this figure would be far exceeded. However, the creation of more employment is a problem which will have to be followed year after year and, therefore, it can be expected that this new surcharge will remain a permanent fixture of India's fiscal policy.

The two additional savings schemes announced by the Finance Minister will have only a marginal impact in increasing the rate of saving which has dropped to about 20% in the current year. Unless the rate of inflation slows down considerably, the ability of the people to save will not increase. Thus there is a direct link between the increase in inflation and the level of savings and between savings and the level of investment in the productive sector.

The reduction in customs duty on general projects from 90% to 80% will only result in neutralising the effect of high cost of capital goods as a result of the depreciation in the value of the rupee. It will have no effect in reducing the cost of capital projects which have sky-rocketed in recent years and resulted in cost overruns both for the public and private sectors.

Nothing has been done in this year's budget to effectively deal with the other major weakness of the economy, namely, the deteriorating balance of payment situation. No meaningful export incentive is sought to be provided except for the pre-budget announcement of reducing the interest rate on export credit.

In fact, the balance of payment situation is likely to worsen inspite of buoyancy in the growth of exports because the import bill for oil and the repayment schedule for foreign debts will result in a substantially higher net outflow of foreign exchange during 1989-90. The only way to bridge the balance of payment deficit is by increasing exports at an annual rate of 30%, but this target will remain elusive unless industry is given the fiscal support to upgrade technology and create a cost effective environment, so that Indian goods are able to compete in world markets.

While the total Central Plan outlay for 1989-90 is Rs. 34,446 crores, the non-plan outlay of Rs. 17,000 crores by way of defence spending and Rs. 7,472 crores by way of subsidies will gobble up a substantial chunk of the budgetary receipts. Thus, a big slice of the rupee will be spent on unproductive expenditure and in view of the increased borrowings taken credit for in this year's budget, the total indebtedness of India will scale further heights.

Thanks to the bounty of nature, the agricultural sector has recovered magnificently. Increase in output by more than 17% has ensured that the targets fixed for many crops have been exceeded and the total foodgrain production is expected to reach a figure of 170 million tonnes, the highest ever achieved in the history of the country. The increase in the production of oil-seeds augurs well for the economy as it will result in reducing the import bill for edible oils.

Industrial growth which has been sustained at the rate of 8% in 1988-89 has not only helped in reducing the inflation to less than double digit figures but has also helped in imparting buoyancy to revenue collections.

As in the past, the pre-budget economic survey for the financial year 1988-89 has highlighted the weaknesses of our economy as being in the fields of balance of payments inflationary pressures and a rising budgetary deficit. If a strong non-inflationary economic growth is to be ensured in the Eighth Plan, there are several macro-economic constraints which need to be tackled.

The most important problem which has surfaced in recent years is the critical balance of payment situation. It has been admitted by the Government for the first time that imbalance in the domestic fiscal situation affect adversely the prospects for growth, price stability and the external balance of payment position.

There are two important ways of restoring the fiscal imbalance:

1) Curbing the growth of current expenditure to restrict the budgetary deficit; and

2) Increasing the surplus generation by public sector enterprises in which Rs. 71,299 crores have been invested.

The first objective can be achieved by eliminating all wasteful and low priority expenditure, by reducing the increase in wages and salaries and by limiting the quantum of subsidies. The revenues have to be made buoyant by increasing industrial productivity and by widening the tax base by covering the rural sector.

The rate of wholesale price increase which has been around 5% during 1988-89 is mainly due to a growth in money supply during the current decade averaging around 6% to 7% per year. This growth in money supply is on account of the budgetary deficits of the Central and State Governments. Thus, the pruning of budgetary deficits would result in restricting the money supply growth, thereby keeping inflationary pressures in check.

The difficult balance of payment situation is due to the following factors:-

1) Fall in indigenous oil production, thereby enhancing the import bill for oil.
2) Bunching of repayment obligations on past loans.
3) Protectionist trends in international trade.
4) Unfavourable climate for concessional external assistance.
5) Uncertainties with respect to the flow of remittances from Indians working abroad.

The only answer to the deteriorating balance of payments situation is to continue to give an impetus to rapid economic growth. This can only be achieved by making the industrial sector more productive and by creating a competitive, cost conscious environment, thereby boosting exports to a level of Rs.30,000 crores per annum.

The Government has rightly cautioned against the temptation to clamp down on imports since past experience has shown that such measures take a heavy toll on industrial productivity and achieve little savings of foreign exchange. Therefore, establishment of profitable units is the only answer to the problem of a difficult balance of payment situation.

The external debt of India is estimated at around Rs.55,000 crores on account of Government, non-Government, IMF and external commercial borrowings. The payment of interest and part of the capital in respect of this debt would account for 24% of the gross receipts of India during the current year. Additional borrowings from abroad would, therefore, be prudent only if such borrowings are invested in productive enterprises which will earn foreign exchange through exports.

If the price of imported oil rises significantly in the years to come, the external balance of payment situation would be even more adversely affected. To guard against this possibility, two steps need to be taken:-

1) Expand the production and use of non-petroleum energy resources; and

2) Price and non-price measures for conservation of energy in industry.

The one constraint for industrial growth, namely, electric power has to be removed by better technologies and improvements in operating performance of existing units. Quick investments in gas based power plants offer attractive opportunities to overcome this problem, which could otherwise become extremely acute during the Eighth Plan period.

The rapid expansion of employment opportunities especially in the rural sector is the only effective strategy for poverty alleviation. The mere implementation of anti-poverty programmes launched in the last two years would have no permanent effect unless employment opportunities are created in the shortest possible time.

The only benefit given to industry is the decontrolling of cement and aluminium, apart from a general reduction in the rate of customs duty from 90% to 80%. A few sops given to the food processing and packaging industries and a reduction in excise duty on skimmed milk powder, condensed milk and food preparations will hardly have any impact on the general industrial organ.

The general increase in existing specific duty rates by 5% and the hike in excise duty on iron and steel forgings and castings and stainless steel will generally have an effect on the price of indigenously manufactured capital goods. Coupled with the increase in the freight rates by almost 13%, the industrial sector is not as lightly spared as it is made out to be.

While no one can grudge the increase in excise duty on low priority items like cigarettes, pan masala and molasses used in the manufacture of liquors, the increase in excise duty on electronic items, mainly computers, is not a step in the right direction.

While the economic survey points out the need for conserving energy, the Finance Minister seeks to do exactly the opposite by increasing excise duty on fuel efficient cars.

A month before the budget, a very adverse amendment was made in the Capital Issues Order to provide that a company is to be listed on the Stock Exchange only if the paid up capital was Rs.3 crores and the amount offered to the public was Rs.1.8 crores. This will virtually mean that all medium sized projects will hereafter not be able to see the light of the day, unless they are set up by promoters who are affluent enough to finance the entire equity issue.

In other words, projects upto Rs.7.5-8 crores will be shelved because these projects cannot be offered to the public for equity participation since their capital would be less than Rs. 3 crores. In fact, even some of the public sector merchant banking corporations have, pursuant to this amendment, rejected applications for financing these projects under their equity support schemes.

This measure is, therefore, clearly detrimental to the industrial growth of India as several medium sized projects are in the offing and will have to be totally dropped. The effect of this amendment to the capital issues guidelines, which unfortunately have gone unnoticed, will be felt in the coming years and will particularly affect food processing and light consumer goods industries which are necessary for creating more employment opportunities.

The rationalisation of the Gold Control Act by exempting gold ornaments from the applicability of the Act, is a step in the right direction. However, with a view to bring down the price of gold in India and to curb smuggling, it is imperative that the flow of gold to the country should be increased by permitting returning non-resident Indians to bring primary gold to India.

Two schemes have been announced for promoting savings. One is in the nature of an equity linked savings scheme, the details of which are yet to be announced by the Government. It is not clear at present as to whether this scheme will have any tax advantages or whether it will be attractive in any way. Therefore, whether the new scheme is effective in mobilising additional savings is doubtful.

The second savings scheme is linked with housing and can be availed of only by an individual who is not the owner of a residential property. This scheme would be through the new National Housing Bank which has been set up.

The scheme provides that an eligible person should deposit a minimum of Rs.30 per month or Rs.360 per annum with the prescribed authority. This deposit should be made regularly for five years and interest at the rate of 10% would be credited to the deposit account.

At the end of the period of five years, the depositor would be eligible to take a loan which would be a multiple of the aggregate amount of the deposit with interest. As to what would be the terms of the loan regarding the rate of interest or the schedule of repayment, has not been indicated.

The aforesaid deposit would be eligible for deduction under section 80-C of the Act and when the loan is taken and the instalment is repaid, it would qualify for deduction to the extent of Rs.10,000 under section 80-C(2) (h). The amount lying in the deposit would be free from wealth-tax, subject to the overall ceiling of Rs.5 lakhs under section 5(1-A) of the Wealth-tax Act.

As and when any bonds or debentures are issued by the National Housing Bank, any person subscribing to the bonds or debentures would be eligible for the capital gains tax exemption under section 54-E of the Income-tax Act. In other words, the bonds or debentures of the National Housing Bank would be treated as specified assets along with units of the Unit Trust of India and the IDBI and HUDCO Bonds.

Apart from these two schemes, no other incentive is given for additional savings. Hence, it is unlikely that these schemes will have any effect in improving the rate of savings of the people which has gone down to 20%.

Two amendments have been made to clarify the existing law and make it more stringent pertaining to sections 32-AB and 115-J of the Income-tax Act. Under the existing section 32-AB of the Income-tax Act, a deduction of 20% of the profits is allowed only to those assessees who carry on "eligible business or profession", which means (i) business or profession other than the business of construction, manufacture or production of any article or thing specified in the List in the Eleventh Schedule (in case it is not a small scale industrial undertaking); and (ii) the business of leasing or hiring of machinery or plant to an industrial undertaking, other than a small scale industrial undertaking, engaged in the business of low priority items as specified in the List in the Eleventh Schedule.

The provisions relating to Investment Deposit Account were enacted as a substitute to investment allowance, which was available to every assessee who purchased a new ship or a new aircraft or installed new machinery or plant in an industrial undertaking, for the purpose of business of construction, manufacture or production of any article or thing not specified in the Eleventh Schedule of the Income-tax Act. The emphasis for availing the benefit of investment allowance was on actual investment in plant and machinery installed to produce or manufacture items of high priority and not on the person who made the investment. However, under the Investment Deposit Account, a person can avail of the benefit even if the investment is made for low priority items. This is not in keeping with the object of development and growth of the priority sector.

To remove this anomaly, the Bill seeks to amend section 32-AB to provide the benefit of deduction to any assessee, deriving income from business or profession, who deposits and utilises the deposit or purchases new machinery or plant to be used in the manufacture or production of priority items, that is, items not specified in the Eleventh Schedule. In order to give adequate notice to the tax-payers, this amendment is proposed to be made effective from 1st April, 1991 and will, accordingly, apply in relation to the assessment year 1991-92 and subsequent years.

Sub-section (5-A) of section 32-AB of the Income-tax Act, provides that the amount deposited with the Development Bank in accordance with the scheme, shall not be permitted to be withdrawn before the expiry of a period of five years from the date of deposit, except in the case of,- (a) closure of business, (b) death of the tax-payer, (c) partition of Hindu Undivided Family,(d) dissolution of the firm, (e) liquidation of the company, and (f) in such other circumstances as may be specified in the Scheme. This sub-section is being interpreted in a manner that in case a withdrawal is made by a tax-payer of any amount standing to his credit in the deposit account after a period of five years from the date of deposit, the condition regarding the purposes for which a withdrawal can be made as specified in the Scheme does not have to be complied with and no tax will be levied on the amount of withdrawal. Such an interpretation is against the legislative intent and may lead to protracted litigation.

With a view to clarify the correct legislative intention in this regard, the Bill seeks to make an amendment in section 32-AB, so as to provide that where any amount is released by the Development Bank even after a period of five years from the date of deposit and the same is not utilised in accordance with and within the time specified in the Scheme, the same shall be deemed to be the profits and gains of business or profession of the previous year in which such withdrawal is made and shall, accordingly, be chargeable to tax.

Further, as the circumstances mentioned in clauses (a) and (d) of sub-section (5-A) may be used for tax avoidance purposes, it is also proposed to clarify that money withdrawn or obtained consequent to the closure of the account because of closure of business and dissolution of firm will be subjected to tax in the year of withdrawl or closure of account and shall be assessed in the hands of the same business or firm as if the business was not closed or the firm was not dissolved. These amendments will take effect retrospectively from 1st April, 1987 and will, accordingly, apply in relation to the assessment year 1987-88 and subsequent years.

Under the existing provisions of section 115-J of the Act, where the total income of a company is less than 30% of its book profits for that year, the total income chargeable to tax is deemed to be 30% of such book profits. For the purposes of the aforesaid provision, "Book Profit" means the net profits as shown in the profit and loss account in the relevant previous year prepared in accordance with the provisions of Parts II and III of the Sixth Schedule to the Companies Act, 1956, subject to certain adjustments which increase or decrease the book profits.

It has been observed that a large number of companies have interpreted the term "book profit" to mean that in case they are following an accounting year (under the Companies Act, 1956) which is different from the previous year under the Income-tax Act (that is the period ending 31st March), then the provisions of section 115-J do not apply to them.

The reason advanced is that the aforesaid section does not make it mandatory for a company to prepare its profit and loss account on 31st March of any year in case it is following an accounting year which ends on a different date. As this is against the legislative intent, it is proposed to make it mandatory for all companies, to prepare their profit and loss account for the previous year ending on 31st March, for the purpose of working out "book profit" for this section. This amendment will take effect from 1st April, 1989 and will, accordingly, apply in relation to the assessment year 1989-90 and subsequent years.

Under the existing provisions certain adjustments are made to the net profit as shown in the profit and loss account. One such adjustment stipulates that the net profit is to be reduced by the amount withdrawn from reserves or provisions, if any such amount is credited to the profit and loss account. Some companies have taken advantage of this provision by reducing their net profit by the amount withdrawn from the reserve created or provision made in the same year itself, though the reserve when created was not added to the book profit. Such adjustments lead to undue lowering of profit and consequently the quantum of tax payable gets reduced.

With a view to counteract such a tax avoidance device, it is proposed to reduce the "book profit" by the amount withdrawn from reserves or provisions only in two situations,namely:-

(1) if the reserves have been created or provisions have been made before 1st April, 1988; or

(2) if the reserves have been created or provisions have been made after 1st April, 1988 and have gone to increase the book profits in any year when the provisions of section 115-J of the Act were applicable.

This amendment will take effect from 1st April, 1988 and will, accordingly, apply in relation to the assessment year 1988-89 and subsequent years.

In conclusion, it has to be stated that the budget proposals will achieve their objectives only if the funds earmarked for various projects are fully spent and percolate down to the most vulnerable sections of our society. The schemes for alleviation of poverty are indeed laudable provided every single rupee finds its way to the right person.

A close monitoring of the various schemes is, therefore, called for and the co-ordination has to be done at the highest level to ensure that there is effective utilisation of the funds. It is indispensable that these schemes should improve the economic well-being of our people because social justice can only be obtained not by bringing down the rich but by bringing up the standard of living of the poorest of the poor. This inexorable principle of economics can be ignored only at our peril.

The views expressed in this booklet are not necessarily the views of the Forum of Free Enterprise.

"People must come to accept private enterprise not as a necessary evil, but as an affirmative good."

— **Eugene Black**

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