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On the Eve

BY the time this issue gets into the hands of most readers, the Budget proposals would have been out. There is, therefore, little point in speculating on the eve of the Budget on what would no longer remain a matter of speculation by then. At the moment, however, what one should look forward to is not the changes in particular taxes or duties which usually excite the most speculation on such occasions but what view the Budget takes of the general and much more important question of guiding the country's economy in the direction of development and growth. Politically it is not a good year for imposing burdens as can be seen from the trend of the State Budgets which have been presented. This is not to suggest, however, that the Centre can afford to be as cynical and as irresponsible as many of the Slates have been.

But there are commitments of two sorts. First, commitments for continued development and strengthening the base of the Plan from which point of view this happens to be a crucial year. For the present Budget will decide whether the Fourth Plan starts off from a sound base or is left to take care, as best as it can, of today's omissions and commissions. The need for a proper phasing is implied in any plan of development. This is, of course, a truism, But the jerks and jolts to which the government, .not knowing its own mind, is continuously subjected makes it difficult to keep to the right track. But time moves only one way. The Finance Minister has another type of commitment, such as the revival of the capital market, which may not be of his own choice but which he has taken upon himself. This will mean some concessions or revision of tax incentives.

About the pressures on the economy there is no room for doubt; they are being felt by everybody and every day. But where do they arise from and how are they to be eased? Of that, despite the advance publication of the Economic Survey one cannot be so sure. From some recent Planning Commission papers, released by the favoured ones who get hold of them, it appears that far from there being a shortfall in private sector investment, calling for incentives and all that, there has been an excess and this has been an important factor—though not the only one — in accentuating the inilationary pressures. The relative shortage of resources is. therefore, in the other sector which has been sought to be made good so far by continuous drafts *on* the banking system and though such drafts over the last nine months have been lower than those in the comparable period in the previous year, they are too large to be ignored. So even if the: Finance Minister would like to give fiscal incentives, his primary pre-occupation should still be to ensure at the same time an adequate surplus to contain inflation.

The need for additional taxation, however, does not dismiss the case for fiscal incentives-incentives to producers and investors, perhaps also to tax-payers to pay their taxes, to complement the steps that are now being taken for more energetic collection and detection of evasion of taxes. It is a master of judgment and of one's own experience which must necessarily be limited. But the time has now come to put it to the test whether dis-incentives to non-payment cannot be made more effective by some incentive to voluntary payment. To repeat, the question is one of judgment but it is difficult to be persuaded that barring really hard cases at one end and regular payers—by

choice or necessity—on the other, there is not a 'sizable intermediate range where a judicious combination of both may not be worth a trial.

And whatever be the case for personal taxation, that for saving calls for a stronger incentive than there is today, say, for company savings. Companies generally have a higher pro* pensity to save than individuals but even *here,* the marginal propensity to consume visibly increases beyond a point and this applies very strongly to the sur-tax on company profits which must inevitably—phony arguments about equity notwithstanding—weaken the incentive to control costs.

Any relief in corporate taxation to promote greater retention of profits must necessarily safeguard against the use of these augmented resources in low Plan priority or non-Plan investments. The solution may be to restrict investments to an approved list which could be varied according to the needs of the day. It may be coal and heavy industries today, chemicals tomorrow so that a fair measure of support may be forthcoming for the particular industries which are considered essential. There is no reason why public sector units should not be included in the approved list. This would be in effect a move in the direction initiated in a token manner by the differential rates of taxation for private companies introduced in the last budget. To make the scheme effective, the investments made by the companies to take advantage of the tax remission on retained profits will have necessarily to be held for a minimum period of years.

Although a scheme like this would help to increase the flow of funds into the capital market, there is also the need to rectify the present discrimination against profits from industries in that they are taxed twice, once in the hands of the company and again in the hands of the shareholders us dividends, while urban property for instance, held by individuals directly, is taxed only once. The Finance Minister has to return to the old established principle of grossing up which was abandoned by his predecessor.

There is thus undoubtedly scope for some play with direct taxes without loss of revenue because by far the bulk of the revenue earners are today the Indirect taxes and a small percentage increase in the latter can more than compensate for some relief in the former and they need not fall on the poor. There is actually a case for substantial increases on items which go largely to sustain luxury consumption. In fact, the conventional notion that indirect taxes are necessarily regressive needs reconsideration. By a judicious choice of items the impact of indirect taxes can be made to fall on selective sectors of consumption. But as a measure for restricting consumption, indirect taxes are nearly played out and the time has come when not only food but a lot of other things will have to be brought under controlled distribution.

The present Budget, to repeat, is the jump off for the Fourth Plan and the Finance Minister must necessarily look before and not after.

More on Viability

THE latest statements of the scheduled banks provide further evidence of the slackening of the pace of credit expansion in the current busy season compared to the last. Thus up to February 12, 1965 the seasonal credit expansion amounted to Rs 208 crores as against Rs 260 crores in the same period last year—a rise of 12 per cent over the pre-seasonal level as against 18 per cent. True, comparison with last year which witnessed an abnormal expansion is not appropriate, but neither is it relevant that credit expansion so far has been higher than in the whole of the 1962-63 season. The economy has been functioning at a higher level of activity than in the 1962-63 season—industrial output, though growing at a .slower rate, is still growing at roughly 6 *per* cent, agricultural output is distinctly larger and we are operating at a price level which on an average is some 15 per cent higher. In the face of these factors. a slower expansion of credit (both absolutely and much more so relatively) than last year would have seemed adequate even without the necessity of further measures. Monetary expansion should be in keeping with the needs of the economy and it certainly does not follow that since monetary expansion exceeded the rise in output last year, it has to be smaller than the increase in output this year.

Despite slower credit expansion, there has been a larger recourse to the Reserve Bank by the commercial banking system; on February 12, 1965 this had amounted to Rs 95 crores as against Rs 62 crores at this time last year. It is known, however, that the State Bank has been primarily responsible for this larger borrowing because *of* its larger commitments (as indicated in the Chairman's Annual Address to the Shareholders of the Bank) to public sector enterprises and to Stale Governments and others for financing procurement of foodgrains—-activities which it is not the intention of credit policy to discourage.

The slower pace of credit expansion has its corollary in a slower growth of money supply this season. Until the first week of February money supply had risen by a little over Rs 200 crores as against over Rs 260 crores last year. There is reason to believe, on the basis of what the Economic Survey has to say, that the operations of the Government have had a smaller expansionary effect this year; the external deficit itself would have had a contractionary effect this year as against a moderate expansionist effect last year. The pace of monetary expansion would thus appear to be restrained even before the monetary screw was given another twist. Prices too since the first week of January have begun to recede. the fall in the month up *to* the first week of February being roughly 4 per cent; the fall in food articles being, significantly, slightly greater at over 5 per cent. This may be a delayed reaction to the bumper harvest and though in the present situation, new monetary measures might accelerate the process to the point of causing a sharp break in prices, a watchful response was more in order than 'ledge hammer methods. The danger that the credit measures may bring about a real squeeze and hamper production cannot be ruled out, particularly as credit demand in certain very important sectors is *yet to* pick up.

The crisis is, as was pointed out last week, temporary, technical and in the sphere of international reserves. The response to that should have also been to tide over a temporary technical difficulty by obtaining short term funds without disturbing the process of the economy reverting to more normal price relationships. Far more important is the need to maintain and step up the tempo of economic activity and add to the strength that has been built up.