PROFITS IN A PLANNED ECONOMY

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

—**Eugene Black**

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By

M. A. MASTER

The earning of profits has been recognised in all countries as essential for establishing and running organisations dealing with trade, commerce, services, industries, etc. Profit-making is now regarded even in Communist countries as vital for ensuring the stability and growth of national economy.

After India attained independence, the promotion of social justice became the most dominant objective of all economic activities. The making of profits began to be looked upon as an act not inspired by patriotism. This new economic philosophy influenced the planners in the early years of our planned economy. The country had, however, to face increasing difficulties during the Second Plan period, in finding resources for the efficient working of the Plan. The planners' faith in their new economic gospel began to shake. The Government thought it both wise and essential to reconsider their attitude towards the question of profits under a planned economy. A Planning Sub-Committee was appointed by the President of the Congress in 1958, and it was asked to recommend the "social and economic objectives", which should be achieved during the Third Plan. In the Report submitted in September 1959, that Committee, presided over by Mr U. N. Dhebar, remarked : "Another method of raising resources is through the profits of public enterprises. The traditional belief has been that Government enterprise should work on no-profit, no-loss basis. This consideration was specially applicable to public utilities like the Post-offices or Electricity Undertakings. But in recent times, it is being increasingly recognised that Govefnment enterprises, like private enterprises, should be allowed, and in fact are required to make profits".

They further gave expression to their considered opinion in the following words: "In a developing socialistic economy, the Public Sector keeps on expanding and relatively more and more goods and services are produced and sold by public agencies. If the State does not adopt an appropriate price-policy based on planned profits, it will gradually find itself faced with the problem of diminishing resources in spite of the expansion of the Public Sector. Prices of commodities and services in the Public Sector should not only be sufficient to meet the cost of production, but also include the following items, *viz.*, depreciation, provision for expansion, contribution to tax revenue and capital formation. The share of the profits of public enterprises in financing the investments must keep on increasing. This cannot happen unless there is a radical change in popular opinion of the nature of the price-policy to be followed in regard to production of State enterprises."

Significant as this vital change was in the attitude of the ruling circles towards profits, it did not make much headway at that time.

We have been advised from the Prime Minister downwards by all important Government authorities, that we should not enter into any controversy in regard to the existence of the Public Sector and the Private Sector in the country. As patriotic Indians, we should look upon all economic activities, as representing the national sector of India. While one appreciates this advice, one cannot shut one's eyes to the realities as they exist.

Do the Public Sector and the Private Sector run their activities on an even keel? Let us examine the position a little closely. The first important consideration which we have to bear in mind, in examining the extent to which profits should be made, is to carefully understand the manner in which Private Sector activities are financed. Normally speaking, equity

capital and borrowed money enable one to carry on such economic activities, as one desires to run. So far, however, as the activities of the Public Sector are concerned, it enjoys a special privilege, which the Private Sector does not and cannot enjoy. If one were to analyse the sources from which finance has been raised for meeting the outlay in the Public Sector, one would find that an exceedingly large portion of its activities was and is financed from the amounts that come from additional taxation, from deficit financing and from the grants given by foreign countries. During the course of the First Plan, out of an outlay of Rs. 1,960 crores in the Public Sector, Rs. 575 crores were provided by additional taxation, and Rs. 531 crores by deficit financing. During the Second Plan, out of an outlay of Rs 4,600 crores in the Public Sector, the sum of Rs. 1,052 crores came from additional taxation and the sum of Rs. 942 crores from deficit financing. So far as the Third Plan is concerned, it is estimated that out of an outlay of Rs. 7,500 crores in the Public Sector, Rs. 2,260 crores will come from fresh taxation and Rs. 550 crores from deficit financing. In addition to this, the Public Sector will be receiving about Rs. 672 crores, by way of grants. In other words, out of an outlay of a little over Rs. 14,000 crores by the end of the Third Plan, a little over Rs. 6,500 crores will come out of fresh taxation, deficit financing and grants. This works out to 47% of the total outlay in the Public Sector.

The significance of this sort of financing is that nearly 47% or almost half the amount of the outlay in the Public Sector, will not have to pay any interest. This amount will not have to be returned. That is not the good fortune of the Private Sector. The finance required by the Private Sector can only come from equity capital and from loans. Interest will have to be paid on the amounts borrowed and dividend will have to be paid on the equity capital raised. It will, therefore, be obvious that the activities of the Private Sector and those of the Public Sector are not on an even keel. While the Private Sector will have to earn interest or dividend, as the case may be, for the cent-per-cent of the finance invested by it, the Public Sector will have to earn only for half the amount of the total outlay made in the units of that Sector. One cannot ignore this basic and crucial consideration in deciding the most serious question as to the extent to which the units of the Private Sector and of the Public Sector should be allowed to earn profits.

The method recommended by the Congress Planning Sub-Committee, of raising resources through the profits of public enterprises, was accepted when the Third Plan was drawn up. The planners wanted the profits of the Public Sector, including the amount provided for depreciation, to contribute Rs. 450 crores towards the finance required for the Public Sector in the Third Plan. One cannot avoid the legitimate conclusian that this new source of finance revealed the fact that the Government ceased to look upon the act of making profits as a non-patriotic one.

In view of the difficulties experienced in raising the resources necessary for the Public Sector during the Second Plan period, and the early years of the Third Plan, Mr. Morarji Desai, as the Union Finance Minister, clarified further the policy of making profits and announced in his Budget speech of 1962-63, that the public sector "must get an adequate return on the vast amount of capital we are investing in our Railways, Power Plants, Irrigation Works, Fertiliser Plants, Steel Plants and the like." Thus the Government had reached the decision that the supply of water irrigation, power and fertilisers must bring the Government adequate return.

The difficulties for raising both internal and external finance continued to increase during the first three years of the Third Plan. Mr. T. T. Krishnamachari, as the Union Finance Minister, went a step further than his predecessor and made it clear that "the Public Sector should not only make profits, but should make good profits". The words "good profits" deserve to be carefully noted. He further crystallised the Government's policy in regard to the making of profits, in the following words : "When the State begins to provide power and transport, when it owns Steel Plants, Fertiliser Plants and Machine-building Plants, it must make sizeable profits out of them, build reserves, amortise loans and provide adequately for depreciation of assets and their replacements, so that the Public Sector can expand without adding unduly to the tax burden."

The announcements made by the two Finance Ministers constitute the latest policy in regard to profits which the Public Sector should make. That profit-making policy holds the field today. It is difficult to say that predominance to social justice is given in this policy, where amongst various other provisions, profits have to provide also for amortisation of loans, replacement of assets and finance necessary for building up reserves, as well as for expansion. The former emphasis on pure social justice has now receded in the background. The conclusion is inevitable that the Government has begun to realise that, after all, the Laws of Economics are inexorable and they cannot respond to the wishes of the Government of building up a Socialistic Pattern of Society.

A further step was taken in this profit-making policy, when the Planning Commission stated in its recent Memorandum on the Fourth Plan that "Capital is a scarce resource and the prices of public enterprises must be so set as to provide an adequate return on the capital employed in them. A return of 12% on the invested capital would be an appropriate criterion for determining the price policy of most public undertakings".

The words "adequate return on the capital employed" in the Public Sector undertakings deserve careful notice.

It will, however, be interesting to know how far the Government has already gone in regard to the return, which it has already been securing from some of the units of the Public Sector. For instance, in the year 1962-63, the Indian Telephone Industry made 16.7% on the capital of Rs. 6.59 crores invested in it; the Hindustan Machine Tools secured 19.8% on the capital of Rs. 11.53 crores invested in that factory ; the Hindustan Antibiotics, with a capital of Rs. 5.48 crores, got a return of 25.5%, and the Travancore Minerals, with a capital of Rs. 70 lakhs, secured a return of 25.6%. The State Trading Corporation, with a capital of Rs. 8.52 crores, provides for the Government a place of pride and power. That Corporation earned a profit of 51.2% on the capital employed in it in 1962-63. These figures, from the Central Government Audit Report (Commercial) 1963, will convince every impartial man that, while the Government may have full faith in the promotion of social justice, as far as its economic activities are concerned, it is now not averse to make profits in some of these undertakings, which might vary from 16 to 51%. One does not know how far the interests of the consumers influenced the decision of the Government in this matter. Let us consider an instance.

It is recognised by all that fertilisers are essential for increasing the yield of various crops, which is the most acute need of the country today. It is, however, only the Central Government which can import the fertilisers and distribute them amongst the farmers. As remarked in the Central Government Audit Report (Commercial) 1963, the scheme of distributing fertilisers by the Government "was initially meant to make the fertiliser available to the consumers on a no-profit, no-loss basis." This was the promise given by the Government. The performance, however, as could be seen from the data given in the Audit Report, was different. It is stated in the Report, that the profits rose from Rs 1.54 crores in 1957-1958 to Rs. 7.44 crores in 1960–1961.

In other words, while the Government secured only Rs 20.10 per metric tonne as profit in 1957–1958, the profit which it made on the sale of fertilisers in 1960–1961 came to Rs. 86.80 per metric tonne : a rise of more than 300% in the profits made on a commodity, which it wanted to sell to the farmers on a no-profit, no-loss basis. Further, the Government entrusted the work of distributing cement in the country solely to the State Trading Corporation. This was not carried out on the principle of "no-profit, no-loss." The Government made a profit of Rs. 11.24 crores in the three years ending 31-7-1959, out of this mere work of distribution. It is difficult to say that due weight was given to the interests of the consumers, when such large profits were made out of the mere work of distribution.

Let us now examine what the correct position is in regard to the return, which the Government has been receiving on the crores of rupees which have been utilised in financing the Public Sector. The Government spent Rs. 6,500 crores for the Public Sector up to the end of the Second Plan. The amount of Rs. 821 crores was utilised for fulfilling the programmes for Agriculture and Community Projects and the sum of Rs. 1,281 crores was spent in providing Social Services, etc. It may be argued that this sum of Rs. 2,110 crores was expended for strengthening the base of agriculture and raising the general standards of living in the country. But the question is : "What about the balance of Rs. 4,450 crores, which were invested up to the end of the 2nd Plan, in Irrigation, Power, Industries, Transport and Communications?" The sum invested in irrigation and power was Rs. 1,435 crores. There is no authoritative publication available to us today from which we can ascertain whether any profit has been made on this huge investment. As a matter of fact, both the former and the present Union Finance Ministers want power-plants and irrigation works to make "adequate profits", "good profits" or "sizeable profits". The public is entitled to know what profits the Government has been making up to now in these projects. If they made any losses, the public is entitled to know what losses they have incurred. All necessary information from the Government on this most vital aspect of our planned economy should be readily available to the public.

The Annual Report on the Working of Industrial and Commercial Undertakings, for the year 1962–63, deals with the investment of Rs. 1,372 crores in the Public Sector upto 1962-63 : Rs. 808 crores as capital and Rs. 564 crores as loans. The working of 30 running concerns in which more than Rs. 1,000 crores were invested, incurred, as stated in the Report, a loss of Rs. 9.14 crores in the year 1962–63. The Hindustan Steel incurred in that year, a loss of Rs. 23.90 crores. The other 29 concerns earned a profit of Rs. 14.77 crores. The total loss on the sum of Rs. 808 crores invested in these concerns, apart from Rs. 564 crores given as loans, came to Rs. 9.14 crores, as mentioned above. So far as Hindustan Steel itself is concerned, the losses up to the end of 1962–63 exceeded the sum of Rs. 61 crores, despite the fact that it enjoyed an "interest holiday" up to the end of March, 1962. Although it is the ambition of the Machine-Tools Industry to build up five such factories, out of the profits to be made by the present one, the results of the working of the units in the Public Sector naturally cause concern to all and call for close scrutiny and careful examination.

In view of the outlay in the Public Sector, which is expected to exceed Rs. 14,000 crores by the end of the Third Plan, the country must make an earnest appeal to the Finance Minister that he should give a general and informing picture of the return, which these huge investments have been giving to the country year after year. The public has a right to ask for such vital information and the Government of a democratic country is under an obligation to comply with the wishes of the people in this matter of fundamental importance.

We have already dealt with the method of raising finance for the Third Plan, out of the profits of the Public Sector, including depredation. The Planning Commission has provided the sum of Rs. 450 crores for this purpose. Experience has shown that this amount of finance will not come from these undertakings. As a matter of fact, the words of warning uttered by Mr. *G.* D. Birla, viz., "It would be a grave miscalculation to provide for earnings of Rs. 450 crores from the public enterprises," have, unfortunately, proved to be true. It should also not be forgotten that the sum of Rs. 450 crores does not represent all profits. As stated in the Report, this sum is inclusive of the amounts provided for depreciation. It will easily be appreciated that, if the amounts provided, by way of depreciation, for a particular industry, are invested in the units of other industries, one is only postponing the evil day. It is, however, surprising to note that the inability of the units in the Public Sector, not being able to provide Rs. 450 crores as finance for the Third Plan, has not deterred the Planning Commission from providing double that amount to be contributed as finance towards the working of the Fourth Plan. The recent Memorandum states: "The aggregate contribution has been estimated at Rs. 1,350 crores consisting of Rs. 450 crores from the Railways, Rs. 650 crores from the other Central Government enterprises and Rs. 250 crores from the State enterprises." It will thus be noted that, as against the provision of Rs. 450 crores in the Third Plan, the finance to be provided for the Fourth Plan, from the working of the Public Sector, will be Rs. 900 crores. It is difficult to appreciate the spirit of optimism which is entertained by the Planning Commission, despite the bitter experience in the past.

Let us now examine how the fate of the Private Sector is going to be shaped. Mr. T. T. Krishnamachari stated in his last budget speech that profits in the Public Sector should be such as would also provide amongst other demands, for the amortisation of loans. This means both the payment of interest on the loans, as well as the repayment of loans by instalments as they fell due. But this provision for the amortisation of loans seems to apply only to the Public Sector. The attitude of the Government in the past leads one to this conclusion.

It is well known that the Government has been fixing the *ex-factory* prices of such items, vital for the stability of our economy, as Cement, Sugar and Steel. The units in the Private Sector producing these commodities cannot, therefore, adopt a price policy on their products as they would like to secure such an amount of return on their capital, as the Government wants to adopt for the products of the undertakings in the Public Sector. Let us take the example of the "retention price" for steel. Although the Tariff Commission provided a sum of Rs. 8/- per tonne for the repayment of interest at 5% on the special advances granted to the Tata Iron & Steel Company and the Indian Iron and Steel Company, towards the cost of financing their expansion, the Government of India disallowed that sum, despite its directive to the Tariff Commission in this connection. This clearly shows that the amounts required for the amortisation of the loans would not be allowed to be included in the profits to be made by the units of the Private Sector. This led Mr J. R. D. Tata, Chairman of TISCO, to remark that, "One cannot but view with alarm this indication of Government's intention to scrap the long standing and salutary practice of seeking independent and impartial advice in fixing prices in major controlled industries". He very rightly added : "In a planned and controlled economy such as ours, it is only by exercising restraint in the use of their economic powers that the Government can retain the confidence of the people in the fairness and impartiality of the policies and actions."

Further, the crucial question is: what will be left in the hands of the units of the Private Sector, after they have parted 50% of the profits as income-tax and super-tax, $7\frac{1}{2}\%$ as dividend tax on the amount of dividend declared, and 40% as sur-tax on the balance of the profits, calculated as laid down in that Act? It is not easy to arrive at the average total burden which all these taxes will impose. The accumulated burden may differ from industry to industry. It is, however, understood from calculations made by experts that the units of the Private Sector are likely to contribute from 65 to 70% of their profits to the Indian Treasury, by way of taxation.

It is pertinent to ask whether the principle of "partners in prosperity" is to apply only to the Private Sector. As the provisions of the Bonus Bill stand today, this principle of "partners in prosperity" will not apply to such Government undertakings, as the Air-India, Chittaranjan Locomotive Works, Perambur Wagon Building Factory, Vishakapatnam Shipbuilding Yard, Hindustan Aircraft Factory, etc. It is difficult to appreciate the non-application of the principle of "partners in prosperity" to such public undertakings, thus depriving thousands of workers employed in them of enjoying the benefits, which the new Bonus legislation is going to bring. To apply one principle to the Public Sector and another to the Private Sector is quite inconsistent with the philosophy of a planned economy.

The broad conclusion is that, after all these payments in the shape of taxation and bonus are made by the Private Sector, considerably small surplus of profits will be left with them. Such a profit will not be able to make any provision, worth the name, for various purposes such as the building up of reserves, amounts required for the amortisation of loans,. the replacement of assets and the expansion of the industries — to which a reference was made by the Finance Minister in his Budget speech. The time has, therefore, come for the people to create such a vocal and effective public opinion in the country, as may lead the Government to make a radical revision in its taxation and other economic policies.

In this context of heavy taxation, what the Central Board of Directors of the Reserve Bank has said on the subject of capital formation is pertinent: "Although there was a distinct improvement in new issue activities during pre-budget months (October 1963 to February 1964) induced by a moderate recovery in the stock market on expectation of relief in the 1964–65 budget, investment confidence did not show any significant revival and the response to new issues by and large is unsatisfactory". This is a sufficient warning to the Government to reconsider its present taxation policy. Moreover, the Finance Minister himself recently remarked that : "the investment climate is not there", "the state of capital market for equity issues, particularly those of new issues, is far from encouraging." His further confession that "a large proportion of equity shares has had to be taken up by underwriters in the recent past" emphasises the immediate need for the Government to make fundamental changes in the present taxation and economic policies.

The situation, as it exists today in the country, causes us all serious concern about the success of a planned economy. The burden of the Central and the States' taxation has taken the widest possible jump from Rs. 730 crores in 1951–52 to Rs. 2,378 crores in 1964–65. Moreover, instead of raising the sum of Rs. 1,100 crores, by way of additional central taxation, as required in the Third Plan Report, as stated in the Report of the Central Board of the Directors of the Reserve Bank, "additional taxation at the Centre in the first three years of the Third Plan is estimated to yield about Rs. 1,900 crores over the entire Plan period." Thus, the estimated revenue from fresh taxation will witness a rise of 73%, if not more. On the top of this existing unbearable burden, if the Government would impose fresh taxation to the tune of Rs. 2,500 to 3,000 crores in the Fourth Plan period, the last lingering hope for creating a self-generating economy and building up a real Welfare State even by the end of the Fifth Plan will completely disappear.

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

RATIONALE OF THE PROFIT MOTIVE

"It appears that there are many people who, even though they have a clear understanding of the regulatory mechanism of our economic system, experience especial difficulty when it comes to a proper appreciation of the dominant role played by the profit principle in the sphere of production. In their legitimate indignation over everything that seems to them to emphasise self-interest at the expense of the community, in their anger at cupidity and usury, they sense behind the dominance of the profit principle something vaguely immoral. In reality, things are far more complex than they appear. True, men today, as always, strive for maximum satisfaction of their desires, but these desires, as always, are very different from one another. Some seek honour and power, others a modest degree of happiness, still others are most content when engaged in the service of the commonweal, and the rest have ambitions only to satisfy to the maximum their purely material needs. But all fear poverty and social degradation. The dominance of the profit element in production is no proof, therefore, that the springs of economic activity are less diverse today than at other times. This circumstance shows only that in the profit principle we have a sure and indispensable criterion for determining whether or not any given enterprise may be fitted into the context of the national economy or not, The dominance of the profit principle merely brings it about that an entrepreneur who fits into this context is rewarded by the market; he who does not is punished by the market. The reward is as high as the penalty is severe, but it is precisely in this way that we are assured of the selection of persons qualified to direct the process of production. And since the fear of loss appears to be of more moment than the desire for gain, it may be said that our economic system is (in the final analysis) regulated by bankruptcy. The collectivist state must find an equivalent regulatory principle: in the place of profitability it will have to establish another criterion of success and another system of selecting the managers of production. It is very doubtful if such an equivalent can be found."—Wilhelm Roepke in "Economics of the Free Society." [Publishers : Henry Regnery Company, Chicago]. (Readers of this booklet who wish to understand the economic mechanism of a free society can profitably study this book.)

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

—A. D. Shroff

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