UNION BUDGET 1993-94: LAYING THE FOUNDATION FOR AN ECONOMIC MIRACLE

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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

Union Budget 1993-94 : Laying the Foundation for an Economic Miracle

By
H. P. RANINA*

This year's Budget will go down in the fiscal history of India as the one which will create the right environment for engineering an economic miracle which has, so far, eluded the country.

India is indeed fortunate to have one of its most distinguished and internationally respected economists, Dr. Manmohan Singh, present his third successive Budget within a span of twenty months. Indeed, Dr. Singh has performed a miraculous feat of cutting indirect taxes by Rs. 4,522 crores, increasing developmental plan expenditure and, at the same time, reducing the budgetary deficit to Rs. 4,314 crores, which is the lowest ever in the fiscal history of India.

The greatest merit of the budget proposals is that the Finance Minister has, with single-minded devotion, attempted to revive the recession ridden industrial sector. The cutting of excise and customs duties, resulting in a loss of revenue of almost Rs. 4,500 crores, will galvanise industry because the cut will enable industrial units to achieve two objectives :

1. Compensate them for the increase in costs; and

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* *The author is a noted tax expert. The text is based on a talk delivered at a public meeting in Bombay on 1st March, 1993 under the joint auspices of several organisations including the Forum of Free Enterprise.*

2. Pass on a part of the reliefs to the consumers, which would create a new wave of demand, reversing the recessionary trend.

In fact, excise duty reductions will over the next two years bring in more revenue for the Exchequer, as the turnover of industrial units will rise dramatically, which will result in larger payment of excise duties. The revival will have a cascading effect leading to higher investments and turnover.

The Government has put the economy in high gear and sought to achieve the following objectives after having successfully got over the critical period of the last one and a half years:

— Globalisation of the Indian economy by making the Indian industry truly competitive;

— Strengthening the fundamentals of the corporate sector in India by reducing excise duties and customs duty across the board, reducing the interest rate and making more credit available through reduction in the CRR and SLR ratios on deposits with banks;

— Creating an environment for a new consumer boom, which will also help the growing middle class;

— Giving a boost to exports by removing the indirect tax imposed as a result of the dual exchange rate; exports are now slated to register a growth rate of 9% in Dollar terms;

— Infusing the right amount of funds in the rural and agricultural sectors, which would also increase the purchasing power in the hands of the rural masses, leading to greater demand for consumer durables.

The Finance Minister has put tremendous emphasis on the development of the agricultural sector. In fact, agricultural output is going to be an all-time high of about 190 million tons. Coupled with this increase, the higher procurement prices will result in greater purchasing power in the hands of the rural masses. Thus, the demand oriented boom will not only revive industrial fortunes, but will set the consumer goods industry on the path of unprecedented growth. The consumer goods industry which is basically labour intensive, will also generate greater employment opportunities, again generating more funds in the hands of the people to fulfil their need for consumer goods.

In fact, the Indian agricultural sector will greatly benefit from the Government's strategy of reducing the high levels of protection given to Indian industry. The more competitive exchange rate which has been brought about, will also give a boost to exports of agricultural commodities and agro-based products, again leading to greater resources in the hands of the rural masses.

Apart from the fact that the full convertibility of the Indian Rupee will increase exports in Dollar terms by atleast 10% during 1993-94, the Commerce Ministry has been given the task of removing all possible restrictions and impediments which have so far dampened the growth in exports. Apart from that, the greater availability of credit for exports to the extent of atleast 10% of the total advances of banks should free many exporters from financial worries.

The reduction in the interest rate by one percentage point and the waiver of interest tax on export credit, will certainly give the required boost.

The Finance Minister has to be congratulated for candidly admitting that despite liberalisation at the policy level, most of the procedures in many areas "remain archaic and cumbersome". He has further promised to review the various corporate and commercial laws and bring them in line with the emerging economic environment.

With this objective in mind, the Government has constituted a Special Review Group in each Ministry of the Union Government to identify changes in the existing laws and procedures. In fact, the same review process has to be initiated by every State Government so as to ensure that the process of liberalisation percolates down to the lowest level of administration.

As enunciated by the Finance Minister in his first Budget introduced in July 1991, the new policy towards foreign investment has to lead to globalisation of the Indian economy. While our neighbouring country China attracts around U.S $ 40 billion of foreign investment every year, India's record in this regard has been dismal over the past decade, as we have attracted no more than U.S. $ 300 million on an average every year. During the current year 1992-93, investment proposals of about U.S. $ 2.3 billion have been approved so far, but the funds have yet to flow into the country.

In this context, the announcement made by the Finance Minister in Paragraph 28 of his Budget Speech is indeed heartening. He has mentioned that the Government has signed the MIGA Convention, whereby investments made by foreign countries will be guaranteed so that foreign investors have the requisite security, specially in respect of their repatriation rights.

In fact, once India becomes a member of the Multilateral Investment Guarantee Agency, separate bilateral investment treaties will be signed by India with several countries, including the United States of America, Germany and the United Kingdom. This will ensure a substantial flow of investible resources into India and, by 1996-97, India should be assured of a flow of atleast U.S. $ 10 billion per annum.

Foreign investment will, in its wake, bring about upgradation of the technical base of India as well as new disciplines, apart from generating employment opportunities for the millions of unemployed and contributing immense amount of revenue to the Exchequer.

The Finance Minister has been wise enough to realise that industrial modernisation, and especially the creation of internationally competitive industries, requires a massive expansion of, and qualitative improvement in, infrastructure. This is especially true of power generation, telecommunications and roads.

Traditionally, these areas have been the preserve of the public sector. Substantial expansion of public investment in these areas is certainly necessary. However, the needs of the country are far beyond the capacity of the public sector to deliver in a reasonable time frame.

The Government has, therefore, adopted a policy of encouraging private sector involvement and participation in these areas to supplement the efforts being made by the public sector. In order to attract such investment, it will be necessary to make changes in policies, procedures and the regulatory framework in these sectors.

The Finance Minister has prudently initiated the reform of the banking sector. He has admitted that the provision for bad debts will absorb more than Rs. 10,000 crores, of which the Government is contributing Rs. 5,700 crores. His proposal to allow banks to access the capital markets in order to raise their capital to meet the new "capital adequacy requirements", is a step in the right direction.

In fact, it has been announced that as much as 49% of the share capital of public sector banks, a well as the State Bank of India, will now be held by the public through a series of issues over a period of time.

The Finance Minister has, while leaving the corporate tax structure unchanged to a substantial extent, given a boost to new industrial ventures set up in backward areas and Union Territories by giving a tax holiday for five years. Likewise, to help the country achieve a higher growth rate in power generation, the much needed boost has been given for setting up of new units by giving a tax holiday for five years.

With a view to giving substantial thrust for encouraging the industrialisation in States and Union Territories which are industrially very backward, the Finance Bill, 1993, proposes to provide incentive for dispersal of industrialisation in remote and industrially backward regions. It is proposed to allow, in respect of any new industrial undertaking located in a State or Union Territory specified in the new Eighth Schedule to the Income-tax Act which starts manufacture or production after 1st April, 1993, deduction under Section 80-IA, at the rate of 100% of the profits in respect of the first five assessment years starting from the assessment year relevant to the previous year in which the industrial undertaking begins manufacture or production.

For the subsequent assessment years, deduction from the profits from such undertakings will be allowed at the normal rate of 30% in the case of companies and 25% in the case of non-corporate assessees. The deduction, at the enhanced rate and the normal rate together, will be limited to twelve assessment years in the case of co-operative societies and ten assessment years in the case of other assessees, as in the existing provisions.

States and Union Territories which are industrially very backward have been identified as those in which, according to the backward area Notification S.O. No. 165 dated 19.12.1986, all the districts are industrially backward. These States and Union Territories are Arunachal Pradesh, Assam, Goa, Himachal Pradesh, Jammu and Kashmir, Manipur, Meghalaya, Mizoram, Nagaland, Sikkim and Tripura and the Union Territories of the Andaman and Nicobar Islands, Dadra & Nagar Haveli, Daman & Diu, Lakshadweep and Pondicherry. The above list corresponds to the existing list of industrially backward areas specified by the Ministry of Industry.

The proposed amendments will take effect from 1st April, 1994 and will, accordingly, apply in relation to assessment year 1994-95 and subsequent years.

Under Section 80-IA of the Income-tax Act, deduction is allowed, in computing the taxable income, in respect of profits derived from a new industrial undertaking or a ship or the business of a hotel, as stated earlier.

With a view to substantially increasing the power generation capacity in the country, the Finance Bill proposes to provide for a full tax holiday for five years and thereafter a partial tax holiday in respect of profits and gains of industrial undertakings set up anywhere in India for generation or generation and distribution of power.

Such undertakings which begin to generate power on or after 1st April, 1993, will be allowed deduction under Section 80—IA at the rate of 100% of the profits in respect of the first five assessment years starting from the assessment year relevant to the previous year in which the undertaking begins generation of power.

For the subsequent assessment years, deduction from the profits from such undertakings will be allowed at the normal rate of 30% in the case of companies and 25% in the case of non-corporate assessees. The deduction, at the enhanced rate and the normal rate together, will be limited to twelve assessment years in the case of co-operative societies and ten assessment years in the case of other assessees, as in the existing provisions.

The proposed amendments will take effect from 1st April, 1994 and will, accordingly, apply in relation to the assessment year 1994-95 and subsequent years.

However a serious drawback of this incentive is that it is given at a time when units generally are not liable to pay tax. The five-year period is to begin from the year of commencement of commercial production or generation of electricity. It is trite knowledge that, during the initial years, a new unit rarely makes a profit and, hence, the question of paying tax would not arise. A tax holiday given at that point of time is, therefore, meaningless.

In fact, power units, being capital intensive, would normally not have a taxable profit for the first eight years and, therefore, the provision to allow the five-year exemption within the initial eight years should be amended to provide that the five-year tax holiday could be claimed only from the year in which the unit has a taxable profit for the first time.

The Finance Minister has rightly given the correct emphasis on research and development by providing a weighted deduction of one and one-fourth times the contribution made to a national research laboratory in respect of a programme approved by the Government. The incentive for making donations to Universities, is also a step in the right direction.

Under the existing provisions of Section 80-M, a domestic company deriving any income by way of dividends from other domestic companies, is allowed the following deduction in computing its total income:-

(i) in respect of a scheduled bank, a public financial institution, a State Financial Corporation, State Industrial Investment Corporation or a company registered under Section 25 of the Companies Act, 60% of the income by way of dividends from other domestic companies;

(ii) in respect of any other domestic company, so much of the dividends from other domestic companies as does not exceed the amount of dividend distributed by the domestic company on or before the due date for filing the return of income.

Under Section 32(3) of the Unit Trust of India Act, 1963, UTI is deemed to be a company and any distribution of income received by a unit holder from UTI is deemed to be dividend income for the purposes of the Income-tax Act.

With a view to providing a level playing field to all the mutual funds, the Bill proposes to withdraw the deduction under Section 80-M in respect of dividend income from UTI in a phased manner. Accordingly, for the assessment year 1994-95, only four-fifth of the dividend from UTI will be eligible for deduction. For the assessment year 1995-96, two-fifth of the dividend from UTI will be eligible for deduction. The deduction will be subject to the existing conditions in Section 80-M. For the assessment year 1996-97 and subsequent years, dividend from UTI will not be eligible for deduction under Section 80-M.

The proposed amendment will come into effect from 1st April, 1994 and will, accordingly, apply in relation to the assessment year 1994-95 and subsequent years.

While the stock market has initially reacted bearishly to the proposals, the capital market will have a substantial boost in view of the fact that the fundamentals of several industries will improve dramatically as a result of reduction in customs and excise duties, the cost free funds which are being obtained as a result of making new issues at a premium, the flow of investment into the stock markets from foreign financial institutions as a result of the rate of short-term capital gains tax being brought down to 30% and, finally, the setting up of a

National Stock Exchange in the coming years which will make it possible for investors to virtually have a paperless trading and very short settlement periods.

In fact, corporate performance results for the first half of 1993-94 will definitely show an upward trend and, therefore, the stock markets will have a boom phase beginning from the last quarter of 1993, taking into account also the fact that by such time the foreign financial institutions would have pumped in almost a billion U.S. Dollars equivalent to Rs. 3,300 crores.

On the indirect tax front, the Finance Minister has reduced the rate of customs duty to an all-time low of 35% on import of capital goods for new projects. Every new project is a goose that lays golden eggs, as it brings into existence new industrial assets, generates employment opportunities and contributes to the revenues of the Exchequer. The reduction in the rates of customs duty from 110% to 85% on general import of capital goods and reduction in the duty on import of components to 25% will also help Indian industry to modernise and renovate its productive assets.

The reduction in excise duty on automobiles will generate more employment opportunities because every commercial vehicle on the road generates eleven to twelve jobs. The reduction in excise duty on a broad band of consumer products will lift the corporate sector out of the morass of recession. In fact, the industrial sector should record a growth rate of 6-7% during 1993-94 as compared to 4.5% during 1992-93.

The one infirmity of the Finance Minister's proposals is that he has not immediately started the process of reducing the interest burden which is going to absorb a whopping Rs.38,000 crores of Governmental expenditure. The Finance Minister ought to have accelerated the process of privatisation by selling a higher amount of public sector equities to the extent of atleast Rs.10,000 crores (instead of Rs.3,500 crores proposed by him) and using the surplus to retire the Government debts, thereby bringing down the interest burden during the next financial year 1993-94.

Instead of doing that, market borrowings will increase by more than Rs.3,000 crores over the current financial year. In fact, the estimates for 1993-94 show an all-time high borrowing of Rs.32,645 crores in one single year, accounting for almost 24% of the total budgetary receipts.

While everybody is wondering as to how the Finance Minister has been able to reduce the budgetary deficit while bringing down the rates of customs and excise duties, the answer is evident from the fact that, for the first time, the Government has reduced non-plan expenditure.

In fact, thanks to the proposals initiated in 1991, the Government has saved almost Rs. 8,000 crores by way of export subsidy, which otherwise would have had to be provided for.

The fertilizer subsidy has been pruned to a figure of Rs. 3,500 crores. In the absence of this bold political decision, an amount of Rs. 11,000 crores would have had to be provided for.

The Government is going to benefit substantially and the balance of payments situation will improve as a result of atleast U.S. $ 1 billion coming to India through the banking channels instead of the illegal "hawala" route.

The floating of the Indian Rupee would also mean that exporters will have a better realisation because the full export proceeds will now be converted at the market rate. Exports are, therefore, slated to rise in Dollar terms by about 12%.

In fact, with the trend towards convertibility on current account continuing, the foreign exchange reserves should remain at a comfortable level of around U.S. $ 6 billion. It can, therefore, well happen that the Rupee may become fully convertible on capital account by 1998. In fact, if Dr. Manmohan Singh continues as the Finance Minister for the next three years full convertibility on capital account would be possible even by 1996.

To sum up, there is no doubt that the budget proposals for 1993-94 will put the economy on the fast lane to industrial recovery and growth. A new phase of consumer boom is on the anvil, leading to a demand-oriented recovery. Exports are also set to record an increase in Dollar terms which will improve the balance of payments situation and put the Indian economy in a better position to reduce its dependence on external borrowing.

There is no doubt that the last three Budgets of Dr. Manmohan Singh have embarked on the exciting task of economic rejuvenation. Industrial and social development have been given top priority and have been put back on the national agenda.

India should now play a major role on the global economic scene. A vibrant and rapidly expanding economy is accelerating its pace to achieve a growth rate of 9% per annum beginning from 1995. This would ensure that before this century is out, the per capita national income will increase from the current figure of U.S. $ 350 to well over U.S. $ 1,000. A sizeable number of the people will emerge from the grinding poverty in which they are today.

At that point of time, the people will look back in retrospect and consider the twenty-month tenure of Dr. Manmohan Singh's Finance Ministership as constituting the turning point in India's economic history.

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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FORUM OF FREE ENTERPRISE

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