SPEECH OF
SHRI YESHWANTRAO BALWANTRAO CHAVAN,
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ON ECONOMIC SITUATION AND TAX PROPOSALS*

Highlights

— *Ordinances to Reduce the Pressure of Demand and Decelerate the Rate of Growth of Money Supply*

— *Discouraging Conspicuous Consumption and Effecting Maximum Economy in the use of Scarce Materials*

— *Fiscal Proposals to help raise Resources needed by the Government*

Sir, the presentation of fresh taxation proposals only five months after I presented the regular annual Budget for 1974-75 has not been an easy decision for the Government. It is an event of unusual significance and derives its justification from the fact that we are faced with a difficult economic situation. I am, however, convinced that not to act in the present situation would amount to fiscal irresponsibility, with serious consequences for the economic health of the country. Thus, the decision to come forward with these proposals is not only an indication of the seriousness of the economic situation, but also a measure of the Government's determination to grapple with it effectively.

It is self-evident that controlling inflation is today the single most important task facing the country. The measures adopted so far by the Government to curb inflation have had a limited impact and the upward pressure on prices has persisted. There is a general expectation of continued price increase, which itself has constituted an inflationary factor.

The thrust of the Central Budget for 1974-75 was to restrain the growth of Government expenditure, mobilize additional resources on a substantial scale, and to reduce reliance on deficit financing. This was part of the overall anti-inflationary strategy. However, judging by price

* *Lok Sabha Debate,* 31.7.1974, cc. 10-24.

trends in the last four or five months, there has been no visible reduction in the strength of inflationary forces operating in the economy. Over the three months April to June 1974 the rise in the general price level was of the order of 7.8 per cent yielding an average monthly increase of about 2.6 per cent, as compared to an average monthly increase of 2.7 per cent during the three months January to March 1974. This continuing deterioration on the price front has been a source of the greatest concern to Government.

I do not wish to dwell at length on the causes for the persistence of inflationary pressures. I have talked about these often enough in this House. I would venture to say that these are basically rooted in the sluggishness of agricultural production. The recent wheat crop has not been up to original expectations. As a result, the tendency on the part of producers to hold back supplies seems to have strengthened. Despite a very sizable increase in procurement prices, procurement so far has fallen short of expectations. The production of oil seeds in the *rabi* season has also been inadequate, and this has strengthened bullish sentiment in the markets in regard to vegetable oil, seeds and oils. Industrial production which remained virtually stagnant in 1973 continues to be inhibited by shortage of power.

All these factors point to the persistence of a sizable imbalance between aggregate demand and supply. As a result, the Government have considered it necessary to come forward with a fresh package of measures designed to reduce the imbalance. The basic objective of the three recent Ordinances, involving temporary restrictions on declaration of dividends, immobilization of 50 per cent of additional Dearness Allowances and of increase in wages and salaries, and compulsory deposits by income tax payers in higher income groups, is to reduce the pressure of demand and decelerate the rate of growth of money supply. In any appraisal of these measures, we must not lose sight of the narrow options open to the Government. In the present situation, the only other feasible course of action would be a drastic cut in all developmental expenditure. This would entail severe adverse effects on the future growth of the economy.

A large expansion in bank credit in recent months has led the Reserve Bank to tighten further its credit controls. Instructions have been issued to each commercial bank to scrutinize the top 50 accounts in order to ensure that bank credit is not used for excessive accumulation of inventories or diverted for non-productive purposes. More recently, an increase of 2 per cent in the Bank rate, accompanied by an increase in both the minimum lending rate and in deposit rates of commercial banks, announced on 22 July 1974, will help to reduce further the incentive to accumulate inventories with the help of bank credit; it will also facilitate mobilization of deposits.

The measures that we have recently adopted are steps in the right direction. Let me be clear; by themselves they cannot stabilize prices. Fundamentally, the imbalances that now exist in our economy can be removed only through a sustained increase in agricultural production, though this is not going to be an easy task because of inadequate indigenous production of fertilizer and steep increases in their import prices. We are purchasing as much fertilizer abroad as we can in spite of the formidable nature of the import bill which is likely to be over Rs. 450 crore. The ample provision that we have made for the core sector in the annual plan for 1974-75 should also enable us to secure a significant increase in the production of coal and steel. Improvements in the production and transport of coal are already visible. Mainly because of power shortages and transport difficulties, the overall outlook for industrial production is, however, uncertain.

Fortunately, our foreign exchange reserves have held up fairly well. This is due mainly to borrowings from the International Monetary Fund (IMF), continuity of external assistance and particularly to a rapid growth in our export earnings during 1973-74. As a result we have been able to finance sizable imports of foodgrains though at very considerable cost. The export outlook for 1974-75 is, however, not equally encouraging. The prices of some of our export products have declined in recent months. In addition, the high current rate of inflation constitutes a serious threat to the maintenance of the competitiveness of our exports, which may threaten the viability of our balance of payments. This only underlines the pressing need to control our rate of inflation.

Against this background, the need for further measures to reduce the pressure of demand in our economy is self-evident. In the present inflationary environment, it is essential to contain the size of the budgetary deficit. This we are determined to do. However, a number of factors have upset our original calculations and are threatening to push up the Central Government's budgetary deficit—well beyond the original budgeted figure of Rs. 126 crore. Let me mention some of these.

As the House is aware, the Government have recently increased the issue prices of wheat in order to scale down the burden of the food subsidy. Currently, there is only a small element of subsidy in the procurement of indigenous wheat and coarse grains. However, on account of unsatisfactory production and inadequate procurement of wheat during the last *rabi* season, the Government is having to import, as I mentioned earlier, sizable quantities of foodgrains in order to maintain the public distribution system. As imported wheat costs much more than indigenous wheat but has to be sold at the same price, the burden of the food subsidy will be much higher than the original provision of Rs. 100 crore.

The weak financial position of the Railways is well known to the honourable members. Because of the higher burden of pay and allowances of the staff and the disruption of traffic caused by the recent railway strike, the deficit in the Railway Budget will increase substantially beyond the original provision of Rs. 52 crore.

Additionally, we must reckon with the fact that by reason of the continuing increase in prices, the budgetary provision for additional dearness allowance will have to be substantially increased. There is also likely to be some increase in expenditure on Defence because of rising costs and further improvements in the emoluments of defence personnel.

On the Plan side, the continued increase in the prices has led to an escalation of project costs accompanied by a further erosion in the internal resources of some of our public sector enterprises.

Taking both Plan and non-Plan outlays together, it seems clear for reasons I have just mentioned that unless a number of remedial steps are taken, the gap between aggregate expenditure and the total resources in sight in the current year will be very much larger than the deficit of Rs. 126 crore which was estimated while presenting this year's Budget. While expenditures have been going up sharply, the trend of yields from taxes at their present levels does not suggest that there will be any substantial excess over the estimate of revenue made in the Budget. It is in this context that I have come before this House with proposals for mobilizing additional resources by way of taxation.

I should like to say, however, that the potential deficit can by no means be covered by fresh taxation only, and that there is clearly need to take other complementary steps to reduce the deficit.

We have undertaken a comprehensive review of all Government expenditure, in a search for possible economies. This is not an easy task because this year's Budget was framed after eliminating many Plan schemes which were considered postponable. Moreover, it would be a self-defeating exercise if a reduction in current outlays were to result in key projects in the core sector being refused the funds necessary for their early completion. To the maximum extent possible, we have to maintain the rate of investment in such core sectors of the economy as power and fertilizers. At the same time we are seeking to effect economies not only in all non-developmental expenditure, but also on development schemes which have a somewhat lower priority. We are also exploring the possibilities of increasing the profitability of our public sector enterprises and departmental undertakings. An exercise to cut expenditure drastically is now under way. Until this has been completed and the results of other measures taken by us are known, it would be difficult to indicate precisely what the final position would be. In view of the acute inflationary situation prevailing we fully intend to contain the Central Government's Budget deficit to the level indicated in this year's Budget and Government will take all necessary steps to this end.

Before I unfold my specific proposals, I would like to explain to the House the rationale underlying these proposals. In the background of the great hardships being endured by the common man, there is clearly no case for imposing fresh levies on articles of mass consumption. Accordingly, in my choice of commodities for taxation, I have avoided imposition of new taxes on the basic necessities of life. At the same time, the need to discourage conspicuous consumption and to effect maximum economy in the use of scarce materials is implicit in my proposals. In addition, I have made an attempt to mop up the windfall gains currently being made by producers and middlemen in certain sensitive commodities, often in the form of undeclared and untaxed profits. I am sure the House will agree with me that in the present inflationary situation, accumulation of inventories far in excess of normal requirements of production, must be discouraged. Some of the recent measures announced by the Reserve Bank of India seek to achieve this objective by raising the cost of bank credit, and by restricting credit only for the genuine needs of essential production. One of the fiscal proposals I shall outline in a few moments seeks to complement the action already taken by the Reserve Bank on the monetary front, while at the same time helping in raising resources needed by the Government.

I would like to take this opportunity to impress upon State Governments that they have no less a vital role than the Central Government in contributing to greater fiscal discipline. In order to reduce their deficits without affecting the pace of development, they ought to exploit fully the potential offered by agricultural taxation. At the same time, there is urgent need for a more realistic pricing of services like irrigation and electricity. I would strongly urge them to take steps in these directions.

Direct Taxes

I shall now explain my tax proposals, dealing first with proposals in the field of direct taxes. As a part of the anti-inflationary package, I propose to levy a tax on the gross amount of interest received by scheduled banks on loans and advances made in India. The banks would be expected to adjust their functioning to this tax and reimburse themselves to the extent necessary by making appropriate adjustments in interest rates charged from borrowers. The proposed tax will have both a monetary and a fiscal impact. In that it will serve the purpose both of raising the cost of borrowed funds and of supplementing Government revenues. The proposed tax will be levied at the rate of 7 per cent of the gross amount of interest earned by the banks. This would imply on an average an increase of about 1 per cent in the cost of borrowings from the banks. Interest on Government securities, as also debentures and other securities issued by local authorities, companies, and statutory corporations will not be included in the tax base. Interest received on transactions between scheduled banks will likewise be exempted from the proposed levy. Interest accruing to the scheduled banks before 1 August 1974 will be outside the ambit of the proposed measure. The proposed tax will be allowed as a deduction in computing taxable income under the Income-tax Act. I propose to introduce a separate Bill shortly to give effect to the proposal. The yield from this measure will be of the order of Rs. 60 crore in a full year. For the remaining part of the current year, however, the revenue will be about Rs. 25 crore.

In view of large unearned incomes accruing as a result of the inflationary situation, I propose to increase the tax on capital gains. The deduction from long-term capital gains allowed in computing the taxable income of non-corporate tax payers is being reduced from 35 per cent to 25 per cent where such gains relate to lands and buildings. In respect of gains arising from transfer of other assets, the deduction is being reduced from 50 per cent to 40 per cent.

The incidence of tax on long-term capital gains is also being increased in the case of companies. This increase is being brought about by raising the rate of tax from 45 per cent to 55 per cent in respect of gains relating to lands and buildings. A lower rate of 47 per cent will be applied in the case of widely-held companies whose taxable income, excluding long-term capital gains, does not exceeds Rs. 1 lakh. The rate of tax applicable on capital gains arising from the transfer of other assets is being raised from 35 per cent to 45 per cent in the case of all companies. These alterations in the provisions relating to the capital gains tax will yield about Rs. 5 crore in a full year.

Indirect Taxes

I now come to my proposals relating to indirect taxes. In order to raise the needed resources, I have no option but to increase Central Excise duties selectively. In doing so, it has been my endeavour to keep to the minimum the impact on the poorer sections of the community. I have also tried to raise duties on those items where the middleman is today retaining a large margin, to the detriment of both the consumer and the primary producer. These duties will help to mop up unintended gains accruing to the trade.

At present copper and copper alloys in crude form, and wire bars, wire rods, etc., carry a basic excise duty of Rs. 1,500 per metric ton. Specified manufactures of these carry a rate of Rs. 2,000 per metric ton, while pipes and tubes are assessable at 10 per cent *ad valorem*. The international prices of copper have been soaring. Even now the bulk of our requirements have to be imported. The indigenous producers of copper have also been selling their products at prices on par with the prices of imported goods, and thus enjoy a substantial benefit as their own cost of production is lower. To siphon off a part of this fortuitous profit, I propose to increase the basic excise duty on copper in crude form and on wire bars, wire rods, etc., to Rs. 4,000 per metric ton; on specified manufactures of these to Rs. 4,500 per metric ton; and on pipes and tubes to 20 per cent *ad valorem*. The existing provisions for collection of duty at the rate of Rs. 500 per metric ton on plates, sheets, circles, strips and foils made out of duty-paid metal, or metal made out of specified types of scrap will continue. A lower rate has also been fixed for sheets and circles cleared in untrimmed condition. The provisions for set-off of duty paid on copper in crude form if used for the manufacture of copper pipes and tubes will also continue. Through these proposals, I expect to secure additional revenue to the extent of Rs. 8.40 crore, inclusive of the consequential accrual of increased auxiliary duty, which is determined as a percentage of the effective basic duty.

On similar considerations, I propose to increase the basic duty on unwroght zinc from Rs. 500 to Rs. 1,500 per metric ton; on specified manufactures of this from Rs. 800 to Rs. 1,800 per metric ton, and on pipes and tubes from 10 per cent to 20 per cent *ad valorem*. Zinc plates, sheets, circles, strips and foils made out of duty-paid unwrought zinc, or specified types of scrap, or their combination, will continue to pay duty at Rs. 300 per ton. The additional revenue accrual from this will be Rs. 5.07 crore inclusive of the auxiliary duty component. Imports of copper and zinc will not, however, be liable to any additional countervailing duty as a result of the increases now proposed on the basic excise duties.

With the rise in prices of rayon and synthetic fibres and yarn, the incidence of duty, based on specific rates, has gone down. I, therefore, propose to step up suitably the specific rates in respect of nylon filament yarn and staple fibre and filament yarn of cellulosic origin. This will provide an additional revenue of Rs. 11.38 crore. The concessional rate available to nylon yarn for use in the manufacture of fishing nets and parachute cords will, however, continue. I am also not bringing acetate yarn within the purview of these increases.

With the objective of reducing the gap in the incidence of the duty at the yarn stage on fabrics manufactured by the composite mills and the powerloom units, I propose to raise the specific rates of duty on cotton yarn normally going into the manufacture of superfine, fine and medium—A fabrics manufactured by powerlooms. The increased rates will also apply to yarn of corresponding counts used in the manufacture of hosiery, sewing thread, etc. Hank yarn in straight reels used by handlooms will remain unaffected. These changes will thus provide some stimulus to the handloom industry. These increases will yield an additional revenue of Rs. 9.70 crore. The honourable members will be happy to know that yarn of lower count groups normally used in the manufacture of medium-B and coarse fabrics is being left untouched.

Due to production constraints, shortages have developed in the availability of tyres, and on certain categories high premia are being charged by the middleman. As a mopping-up measure, and to raise revenue, I propose to step up by 5 per cent the *ad valorem* duty on tyres, other than those meant for scooters, motor cycles and mopeds, which will continue to carry the present concessional rate. This will yield an additional revenue of Rs. 8.80 crore. Tyres and tubes for cycles, and tyres specially designed for use in animal-drawn vehicles will, however, continue to be wholly exempt.

The honourable members are aware of the general scarcity of cement, and the windfall gains being reaped by the dealers. To absorb at least a part of these gains and to raise additional revenue, I propose to increase the basic duty on cement from 25 per cent to 30 per cent *ad valorem*. Inclusive of the consequential increase in accruals from the auxiliary duty, this proposal will add Rs. 29.37 crore to the revenues.

The present tariff rate of basic excise duty on cigarettes is 200 per cent *ad valorem*. By a notification, basic duty has been prescribed at 75 per cent *ad valorem*, if the value of the cigarettes does not exceed Rs. 10 per thousand. In respect of cigarettes having a value higher than Rs. 10 per thousand, this duty is increased by 3 per cent *ad valorem* for every additional rupee or part thereof in excess of Rs. 10 per thousand. As a revenue measure, I propose to raise the rate of basic duty at the base point (*i.e.,* cigarettes of which the value does not exceed Rs. 10 per thousand) from 75 per cent *ad valorem* to 85 per cent *ad valorem*. The incremental rate of 3 per cent *ad valorem* for every additional rupee or part thereof in excess of the value of Rs. 10 per thousand will, however, continue.

As the ceiling of 200 per cent *ad valorem* restricts the duty on the more expensive brands, I also propose to raise this to 250 per cent *ad valorem*. I would hope those fortunate enough to afford to more costly brands will feel more virtuous in the knowledge that they will now be contributing in larger measure to the Exchequer. The additional revenue from my proposals relating to cigarettes will amount to Rs. 16.45 crore inclusive of the increased accrual by way of auxiliary duty.

I also propose to raise the basic duties in respect of pig iron, latex foam sponge, asbestos cement products and electric lighting bulbs and flourescent lighting tubes. These will together yield an additional revenue of Rs. 8.14 crore.

As a measure for raising additional revenue exclusively for the Centre, I propose to step up the rates of auxiliary duty on steel ingots, and iron or steel products, from 75 per cent to 100 per cent of the effective basic duty, and that on skelp, tin plates and tinned sheets from 50 per cent to 70 per cent of the effective basic duty. Rails and sleeper bars used for railway track will not, however, attract the increase. These proposals while bringing the indigenous prices more in tune with the imported prices of comparable products, will also help to raise an additional revenue of Rs. 26.85 crore. These revised auxiliary duties will as hitherto apply only to indigenous production, and not result in higher countervailing duty on imports.

On certain varieties of cotton fabrics like suiting, gaberdine, furnishings, blended, embroidered, and impregnated or coated fabrics, I propose for the first time an effective levy of an auxiliary duty of excise at the rate of 33.33 per cent of the effective basic duty; this will yield an additional revenue of Rs. 6 crore.

The specific rates of duties on various categories of paper and paper board were reviewed and stepped up as a part of my Budget proposals presented in February 1974. Since then the steep increases in the prices of most varieties of paper and paper board effected by the industry have brought down considerably, in percentage terms, the *ad valorem* incidence of the existing specific duties. I am, therefore, constrained to step up the duty on various categories of paper and paper board for the second time this year. I accordingly propose to levy an auxiliary duty at the rate of 33.33 per cent of the effective basic duty on all varieties of paper and paper board. Commoner varieties of printing and writing paper, not exceeding 65 grammes per square metre, used for exercise books, text books, etc. and assessed at present at a concessional rate of 15 paise per kilogram are being specifically exempted from the proposed auxiliary duty. Newsprint and hand-made paper and paper board will also not be affected. This measure will result in an additional revenue of Rs. 13.20 crore.

In an effort to narrow the gap between the indigenous and imported prices of plastics, I propose to increase the auxiliary duty of excise from 20 per cent to 40 per cent of the effective basic duty, and thus, raise an additional revenue of Rs. 9 crore. However, plastics when imported will as hitherto continue to be exempted from the countervailing duty, equal to the auxiliary duty of excise.

I also propose to increase the auxiliary duty on paints and varnishes from Rs. 33.33 per cent to 50 per cent of the effective basic excise duty, which will bring an additional revenue of Rs. 1.80 crore.

Till recently DMT and caprolactam were being imported at high international prices. The indigenous production of DMT has since started while the caprolactam unit is expected to go into production shortly. Having regard to the prices at which these products were imported and as a revenue measure, I propose to levy a duty for the first time at the rate of 50 per cent *ad valorem* on caprolactam and 25 per cent *ad valorem* on DMT. This is expected to yield a revenue of Rs. 12.40 crore. The proposed levies will not result in countervailing duties on the imported caprolactam and DMT.

The proposals relating to excise duties will lead to a gain in revenue of about Rs. 166 crore in a full year, of which about Rs. 20 crore will accrue to the States and Rs. 146 crore to the Centre.

Customs Duties

The inflationary trends in international prices to which I had referred in my Budget speech in February 1974 continue. In these circumstances, I have decided to leave unchanged customs duties proper, though additional revenue to the extent of Rs. 1 crore is expected from countervailing duties consequent on the changes proposed in Central Excise duties.

Where changes are proposed to be effected by issue of notifications effective from 1 August 1974, I shall in due course lay copies of such notifications on the Table of the House.

Taking Customs and Central Excise duties together and exclusive of States' share, the additional revenue accruing to the Centre will be of the order of Rs. 147 crore in a full year of Rs. 98 crore approximately for the rest of the current financial year.

The various tax proposals, both direct and indirect, that I have outlined will yield a revenue of approximately Rs. 210 crore in a full year and Rs. 123 crore in 1974-75 for the Centre. The States will also receive Rs. 22 crore approximately in a full year and Rs. 13 crore approximately during the current year, as a result of these proposals.

As I stated earlier, the presentation of fresh taxation proposals is not an ordinary event. The economic compulsions of the current situation do not leave us with any really viable alternatives. It is in this perspective I would wish the House to view and to judge these proposals.