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SET THE PEOPLE FREE

An Open Letter to the Finance Minister

My dear F.M.,

The Union Budget that you will introduce on 28th February will be an important one as it will at last reveal to the country whether the Janata Government has a clear perspective of what has been wrong with our economy for the last two and a half decades and how matters can be put right.

In contrast to other countries in Asia which have been making rapid strides to prosperity and a higher standard of living for their people such as Japan, South Korea, Malaysia, Singapore, Hong Kong and Taiwan, our own country, despite some gains, has by and large stagnated and the standard of living of the people has not perceptively risen since Independence. What is worse, during the past two years with a population growth of two per cent per annum, the per capita income has recorded an absolute fall.

Our friend Nani Palkhivala had, in the speeches he made commenting on the Budgets of your various predecessors, repeatedly urged the need for undertaking a 'U Turn' in our budgeting policies. It is because I feel it is high time that such a 'U Turn' is now executed by you that I venture in all friendship to make this plea. Your last Budget was by way of being only an interim one and it was widely appreciated that you had come on the scene much too late for it to show the impress of your own hand. At that time, high hopes had been expressed that your second budget would be cut out of very different cloth.

Let me now try to indicate what in my view are the country's crying needs in so far as they relate to financial or taxation proposals.

The first and most desperate need of the hour is the lowering of the rates of taxation, both direct and indirect. The rates of direct taxation are exorbitant and they have long since passed the point at which the law of diminishing returns operates. Not only are these imposts oppressive, but they are also counter-productive because they compel even normally honest citizens to avoid and even evade taxation. Prof. Parkinson has explained this process in his book '<u>The Law and the Profits</u>'. Tax evasion has unfortunately become

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a massive phenomenon, as was appreciated by the Wanchoo Committee in their Report in 1972. While the tax evaders have been escaping tax from year to year owing to the feeble and lax collection system, the honest-to-God middle classes with fixed incomes are being cruelly overtaxed. It has been estimated by a dissenting member of the Wanchoo Committee that income on which tax was not paid in 1968-69 was of the order of Rs.2,800 crores.

The effect of relief in the rate of direct taxes would be to free a self-employed entrepreneur or professional man from resorting to evasion and encourage him to invest his savings in his own business or vocation. Every rupee that is allowed to ~~fortify~~ fructify in the pocket~~s~~ of the citizen is likely to be more productively used than it would be if appropreated by Government.

In the early 70's and particularly in the budget for 1974-75, certain cuts were made in the maximum rates of income tax and this, as was to be expected, was rewarded by a sharp rise in actual yield. Unfortunately, that healthy trend was reversed in your budget last year. It needs to be revived again, not only in order to give instant relief and stimulate investment but also to give hope to those who would like to save and invest provided they are no longer punished as they have been for doing so. In this connection the exemption from Capital Gains Tax to those who invested from sales proceeds which would normally have borne tax was a step in the right direction. The case for such a measure is strengthened by the effect of the ruinous chemistry of inflation acting on a "progressive" system of income tax - devaluing fixed value deductions while the tax-payer floats into a higher tax bracket.

Counter-productive trends have also been at work in regard to indirect taxation. There were only fifteen items which were subject to Central Excise duties in 1951. The number of those items have now shot up to 133, accounting for not less than 52 per cent of the total tax revenue. Alongside of this there has been a corresponding increase in other levies such as the sales tax levied by the States. These imposts on the needs and comforts of life fall particularly heavily on those sections of the people who can bear them least. Here again, excessive excise duties have become a major source of corruption in the corporate sector where many firms find it necessary to understate their actual production.

The way to redress the balance between direct and indirect taxation is not to raise the rate of direct taxes but to lower the burden of indirect taxation on industry, which should lead immediately to a much-needed rise in the gross profits of the industry concerned. Since a Reserve Bank study of company finance shows that between 61 and 63 per cent of all additional profits come back to Government by way of corporate taxation, this would also mean a bonanza to the public exchequer.

The cummulative effect of excessive direct and indirect taxation has been to bring down to unacceptable levels the margin of profit in industry, thereby discouraging much needed investment and expansion. Professor P.R. Bramananda recently drew attention to this in his inaugural address to the Indian Economic Association. Alongside of the fall in the level of profits there has been a rise in what is called the "hurdle rate", namely, the rate of return on investment that has to be anticipated to persuade the ~~particular~~ potential investor to invest.

It is hardly surprising that, in the light of all this, entrepreneurship is drying up and initiative and enterprise are at a discount. The net effect of two decades of budgeting of this nature has been to depress profits and investment, dry up savings, increase consumption, create unemployment and let loose inflation. These trends can be reversed by a drastic cut in the rates of direct and indirect taxation. These should apply not only to such necessities as sugar and matches but also cold storage equipment, air conditioners, and motor cars, none of which can any longer be called luxuries in the 20th century. The L.K. Jha Committee has already pointed out the urgent need to remove all taxes on imports, whether they are cement, steel or fertilisers. That however would be only a small begining.

We shall be told that such drastic reduction in taxes whether direct or indirect would involve a drop in revenue. This apprehension is somewhat questionable. Has it not been demonstrated by President Kennedy and others that a cut in the rates of taxation can result in an increase in the actual revenues or that, in other words, a small slice of a large cake is bigger than a large slice of a small cake? Assuming however that you will have to budget for lower revenues, this will have to be balanced by a drastic cut in unproductive civil expenditure. We now have in government offices a bloated class of under-paid and underemployed clerks and functionaries. No country can prosper if it has to carry the burden of an army of unproductive parasites. Your predecessors talked of the need for such a drastic cut in civil expenditure but a lack of courage prevented them from implementing their budget speeches. A drastic cut in unproductive expenditure will not only facilitate tax reduction but also ensure an avoidance of deficit finance and the resulting monetary inflation.

In case it is pointed to you that all this is "politically inadvisable", surely the answer to such a plea is that it is certainly even more "politically inadvisable" for your Government to allow the present drift to continue and to show that it is not prepared to grapple with the country's basic economic problems.

It may not be altogether irrelevant to point out that, according to the London Times Business News of January 16, 1978, a meeting between senior Bank of England officials and a panel of top economists came to the conclusion that in order to boost the British economy, tax cuts amounting to £2,000 million need to be made in the Budget that the Chancellor of the Exchequer is going to introduce within the next few weeks.

It was good to read that, in your speech in Surat, where you addressed the Southern Gujarat Chamber of Commerce and Industry on January 20, you quite rightly deplored the way in which businessmen have got used to cultivating their "licensed gardens" and observed that "development behind a protective wall for decades seems to have atrophied the capacity of businessmen to take risks". This evil was described by Rajaji, with whom you and I had the privilege to work closely for a decade, as the creation of "private monopolies" and he quite rightly called for an end to what he described as "permit-quota-licence-raj". Is it not high time that all controls, including those on foreign exchange, should now be lifted and the Indian people set free from the straitjacket of an over-controlled economy?

As you are aware, the "German miracle" was brought about by a policy courageously introduced by Ludwig Erhard of lifting all controls overnight in defiance of the Allied Commanders then in control of West Germany. "Let the men and the money loose and they will make the country strong", he urged, and the whole world watched the result with admiration.

Our political democracy, which involves an election every five years to Parliament and State Assemblies, needs to be supplemented by economic democracy which consists of the ballot of the market place where people cast their votes not once every five years but every day as they go about their daily business of saving and investing their money or spending it. The restoration of a free market needs to be accompanied by the restoration of free collective bargaining in the sphere~~s~~ of our currently bedevilled

Industrial Relations.

All this can only be made possible by the Government's withdrawal from territory which should never have been taken away from the citizens of this country. That is what decentralisation of power means.

The people of India have tremendous intelligence and vitality. Once they are freed from the trammels of red tape and excessive controls, I for one have no doubt they will go places and raise their standard of life. The task before the Janata Government is to set the people free in the economic sphere as they have already done at the political level. Your Budget could be the first step in that noble pursuit.

I realise that, as a member of a conglomerate Government, you may not be entirely the master of the nation's exchequer, but you can yet do a great deal to give a lead to your colleagues in the government and the country as a whole.

Hoping to be forgiven for this public plea which I have felt it necessary to make,

Yours sincerely,

MINOO MASANI