Coating bitter pills with sugar

Uttam Gupta

THE Union Budget for 2003-04 seeks to accelerate the pace of economic growth while maintaining fiscal discipline. Other important objectives of the Budget are eliminating poverty, increasing employment; building infrastructure — both physical and social; increasing productivity in the manufacturing sector; bringing about all-round reduction in cost, and increasing exports. The best way to propel growth is to put more money in the housewife's purse so that there is an increase in demand. Mr Jaswant Singh had promised this immediately after he took over as Finance Minister. He could have achieved this by implementing the recommendations of the Kelkar Task Force on Direct Taxes.

But, brushing aside the panel's proposals, the Finance Minister has merely increased the standard deduction by Rs 10,000 for persons with income up to Rs 5 lakh besides removing the 5 per cent surcharge. While these relaxations may leave a little extra money with salary-earners, they will hardly make a dent on the demand. In fact, demand is unlikely to get a big push so long as Section 88 remains in place.

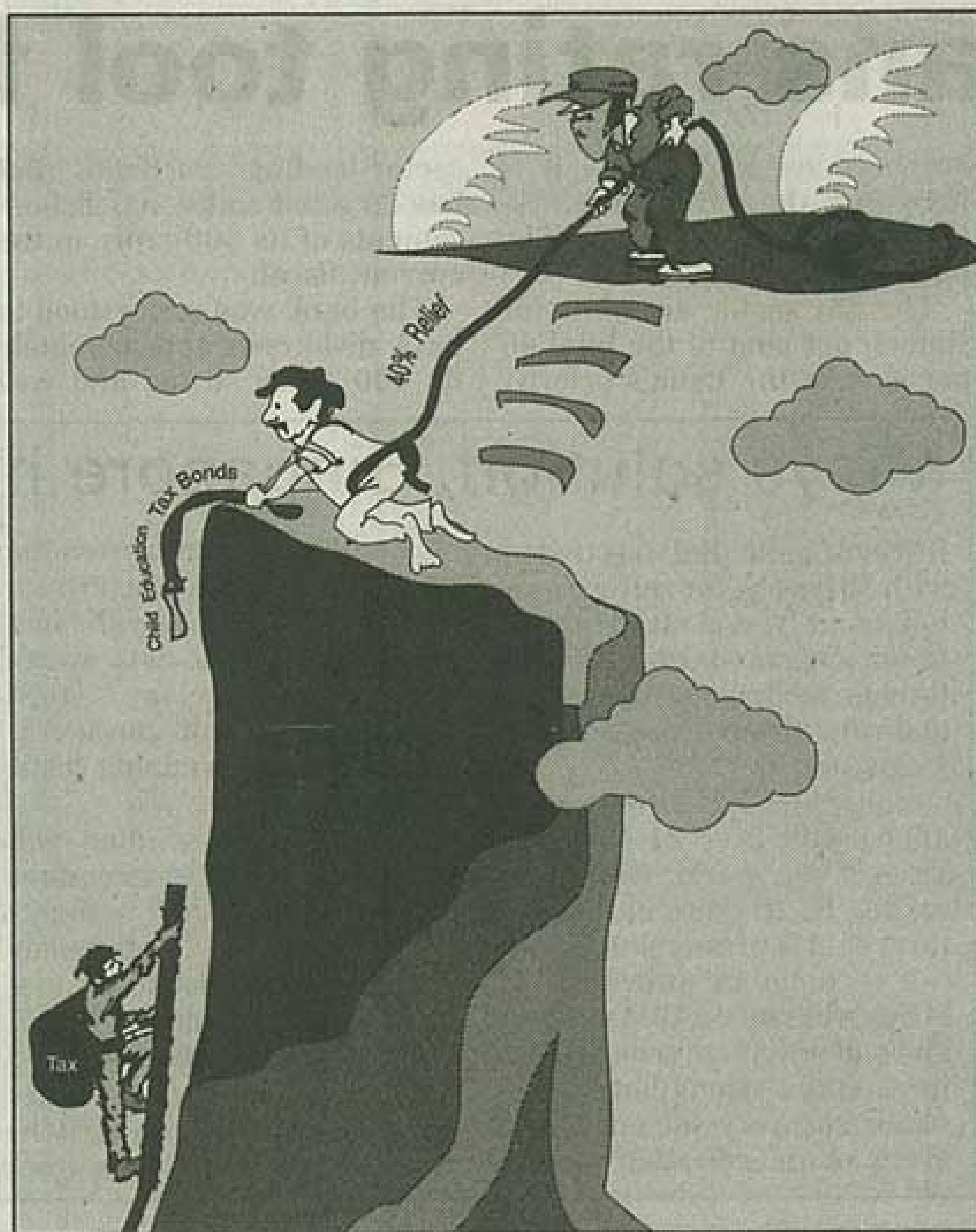
Under Section 88, until now, a person had to invest Rs 1 lakh in specified savings instruments to save Rs 15,000 in tax. Even adjusting for expenses on a child's education (Rs 12,000 for one child, and Rs 24,000 if there are two) allowed in the Budget, the amount of cash outflow will still be substantial.

An individual should have full freedom to take a decision on disposal of his income. This is denied to him under the existing dispensation. He will get it only after Section 88 is abrogated. While this may lead to loss of a virtual 'captive' source of funds to institutions such as LIC, IDBI, etc., the Government should view this in the overall interest of ensuring optimum utilisation of resources and accelerating growth.

The Finance Minister has unveiled an ambitious plan for building roads, railways, ports and airports. Where will the funds (estimated at Rs 60,000 crore) for this infrastructure come from? The Government would like the private sector to invest and has promised to fill the so-called 'viability gap'. Put simply, the former will reimburse to the latter the difference between the desired/target return, on the one hand, and the actual return, on the other.

Due to the long gestation period and uncertain revenue streams (especially true of road projects, where the bulk of the investment is contemplated), the lenders are generally reluctant to take exposures in infrastructure projects.

Perhaps, in a bid to overcome this and attract funds at any cost, the Government seems to be heading for open-ended sovereign guarantees. Having burnt its fingers in a couple of projects in the power sector, it needs to tread cautiously. Instead of latching on to the easier option of offering full guarantee cover and then facing catastrophic consequences, the Government should create an enabling environment under which the projects become attractive on their inherent strength. This would require a two-pronged strategy of cutting bureaucratic red-tape and giving speedy approvals/clearances, while cultivating a habit of payment among the users of such common facilities.



The Budget lays emphasis on diversification of agriculture. But there is no action plan to back it up. The talk of promoting hi-tech horticulture, fertigation, use of biotechnological tools, production of green food, and so on, is merely academic. Augmentation of the irrigation facilities is a basic requirement for increasing productivity and achieving crop diversification. And, yet, Mr Jaswant Singh has paid little attention to this!

A major bottleneck in diversification has been indiscriminate support to cultivation of wheat and rice by way of 'open-ended' procurement at the minimum support price (MSP). The Government has given no indication of its intention to break away from this vicious circle. While it may have problems in completely doing away with the existing dispensation for wheat and rice, the least it can do is to extend support to such crops as pulses and oilseeds, thereby providing them a level playing field. The Finance Minister has expressed concern that agriculture has not benefited from the general reduction in the interest rates. Accordingly, the RBI will advise commercial banks to extend credit to farmers within a band of 2 per cent around the prime lending rate (PLR). Even with this, the interest charged them, (at 12.5 per cent) will be quite high.

The Finance Minister has expressed concern over the subsidy on food, fertilisers, kerosene and LPG. But what is being done to rein in these subsidies? On fertilisers, having stated that increase in price of hydrocarbons is the prime cause, he had proposed a modest hike of 2-5 per cent in the selling price of various fertilisers to partially neutralise the impact. But even this was opposed by almost all political parties, necessitating a rollback!

To spur growth in the industrial and services sector, the Kelkar panel had recommended doing away with sector-specific exemptions to the corporate sector and making incentives transparent by reducing the tax rate.

As in the area of personal income-tax, on this front also, the Government has ignored the KTF recommendations. It has not only kept the existing plethora of exemptions intact, but also expanded their scope. In the power sector, for instance, several more projects have been given the status of mega projects, conferring on them the benefit of complete exemption from Customs duty, a 10-year tax holiday, deemed export benefit to domestic suppliers of capital goods, and so on.

Therefore, the present syndrome of pushing projects on the baggage of fiscal concessions, rather than on their inherent strength, will continue.

That apart, various measures announced in the Budget have only added to the uncertainties of the capital market. For instance, the exemption of investment in equity from capital gains tax will be reviewed at the end of 2003-04. In regard to 12.5 per cent dividend distribution tax levied in lieu of dividend tax in the hands of shareholders, too, the Finance Minister does not seem to be sure whether he will retain it!

The pricing of petroleum products holds the key to the cost structure of several industries. The steep increase in international crude prices has resulted in costs across sectors increasing by leaps and bounds this year. And since the fiscal levies on these products are on an *ad valorem* basis, the Government has also reaped a bonanza in higher revenue collections.

To minimise the cascading effect and impart a degree of stability in prices, the Kelkar Task Force had recommended adopting a system of 'specific rate' of duties on petroleum products. The Government has quietly ignored this.

Further, by imposing a 50-paise cess on petrol and diesel (in addition to the existing cess of Rs 1 per litre), a Rs 1.50 per litre cess on LDO and a Rs 50 per barrel cess on crude oil — both domestic and imported, it has only added to the burden on consumers.

There has been much brow-beating about the reduction in rail freight by 10.5 per cent on petrol, 7.5 per cent on diesel and similar reductions for such other petroleum products as naphtha, fuel oil, etc.

However, their impact on the overall delivered cost pales into insignificance when compared to the increase resulting from the hike in basic price linked to the import parity price (IMPP). Since April 2002, the cost of naphtha has increased by 50 per cent and, that too, on a high base of about Rs14,000 per tonne!

The Finance Minister has announced the introduction of the State Value-Added Tax (VAT) from April 1, 2003. He is confident that this will help reduce the cost of goods to the consumers by removing the cascading effect of tax levied at earlier stages in the value chain.

However, the situation on the ground does not warrant this optimism. First, the Government has decided to retain Central Sales Tax (CST), though at reduced rate of 2 per cent during 2003-04 and 1 per cent during 2004-05, leading to complete withdrawal only in 2005-06. Since the VAT laws do not allow for tax credit on CST, this will defeat the very objective.

Second, as per reports, initially, petroleum products will be kept out of the purview of the input tax credit schemes. In view of this and considering that tax on these products constitutes a major share of the cost of production, industries will remain burdened with their cascading effect.

Even when the set-off for tax paid on these products is permitted, the levy of a high 20 per cent VAT (due to their treatment as de-merit goods) will cause hardship, especially to those industries whose tax liability on the finished products is lower — for instance, fertilisers.

Third, despite public pronouncements to the contrary, the State governments are unlikely to withdraw all the existing local taxes, such as entry tax, purchase tax, turnover tax, and so on (this may be seen in the light of the Supreme Court upholding the validity of some of these taxes). Now, if these taxes remain on the State alongside VAT, and credit for such taxes is also not allowed, this could lead to serious consequences.

The Finance Minister has concluded his Speech by stating that the Budget is all about accelerating growth, banishing poverty, getting the best out of human capital and bringing prosperity to all.

This is not borne out by the proposals in the fine-print. These are merely an attempt to coat with sugar the bitter pill that the common man is being made to swallow day in and day out.

(The author is Additional Director (Economics), Fertiliser Association of India, New Delhi.)