A PRIMER ON BUDGETARY POLICY

OR, HOW TO GET RID OF MONEY ILLUSION

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Chorus: "For fear, enforcing goodness,
Must somewhere reign enthroned,
And watch men's ways, ...
....
This above all I bid you: reverence
Justice' high altar; let no sight of gain
Tempt you to spurn with godless insolence
This sanctity.........."

Aeschylus, The Eumenides, 519-44.

Mr. V.P. Singh's second Budget is not as novel as was his first, but it provides an interesting instance of learning by doing of an honest and hard working man, though the process appears painfully slow and there is no sign as yet of the Finance Minister's coming to grips with the basic issues relevant in this connection. At about this time last year we drew attention to some of the palpable absurdities of the policy package contained in the previous Budget (EPW, 1985, pp.707-10), e.g., the cut in Plan allocation for Rural Development and related programmes with FCI's stock of foodgrains mounting to 30 million tonnes; liberalisation of imports in the face of the foreign exchange constraint; and encouragement of the inflow or projects and equipments from abroad while the domestic capital goods sector was plagued by the problem of underutilised capacity. Some of the measures taken in the current Budget - e.g., the sixty four per cent increase in the Plan allocation on Rural Development and Employment Programmes over the last year's figure (Budget Estimate), the ten per cent rise in basic customs duty on capital goods and project imports along with a 5 per cent deduction in the import duty on components of capital goods, and the upward revision of customs duty to 110 per cent" in respect of 32 machine tools where domestic production has been established" (Budget Speech, p.41) - are in fact designed to undo the damage done by the previous Budget on the three fronts noted earlier.

While the reversal of the policy in these respects is no doubt welcome, the central thrust of the fiscal measures is still far away from the major objective that "greater production... be allied to juster and more equitable distribution, so that the increased wealth may spread out among the people" (Nehru, quoted in Long Term Fiscal Policy, p.1). In examining the most important features of the Budget proposals we require to keep in constant view this fundamental objective; but of more immediate interest to us is the extent to which Mr. Singh's policy addressed itself to the pressing problems "of raising resources for the Plan without fuelling the fires of inflation" (Budget Speech, p.4), of disequilibrium in the Balance of Payments, and of the sharp rise in the number of job seekers (the rate of increase being 8.7 per cent between end August 1985 and end August 1984) - problems which the Economic Survey itself underscores (pp. 45-46,61, 75, 95-6), and the solution to which will go a long way towards the attainment of the major objective noted above.

1. <u>The Simple Economics of Resource Mobilisation : An Aggregative View</u>

It is elementary but important to remember that resource mobilisation through the Budget for development planning consists not so much in gaining command over funds, but more in releasing resources for capital formation in the desired direction. From this viewpoint the efficacy of the Budget is indicated as a first approximation by the surplus on Revenue Account, and <u>not</u> generally by the various categories of borrowing which account for around 40 per cent of the total receipt of the Union Government. The reason is that internal loans taken by the government ordinarily constitute not a net addition to the investible surplus of the economy, but a transfer from the private to the public sector. Such borrowings contribute to resource mobilisation only to the extent people are induced to consume less by the high rate of return on these financial assets (due largely to fiscal concessions granted to their holders). However, though saving in <u>a particular form</u> has been found to be responsive to its yield (relatively to other types of assets), there is no evidence to suggest that <u>aggregate</u> saving out of a given level of income is positively related to the net interest rate. This has important implications for policy measures which appear not to have been adequately appreciated so far by the framers of the Budget.

Resource demobilisation through incentives to saving

The point to note here is that the various fiscal incentives devised for the promotion of saving may have exactly the opposite effect, as they enable the tax payer to raise his disposable income for the same amount of saving merely through a switch to some specified form of financial asset(s). Thus consider the case where the individual decides to buy dB amount of National Savings Certificates at the expense of fixed deposits with commercial banks. Additional consumption as a result of this shift in the portfolio is given by:

$$dC = cte\, dB \qquad \ldots\ldots \quad (1)$$

where dC = additional consumption; c = marginal propensity to consume out of disposable income; t = marginal tax rate; e = proportion of saving (in the particular form) exempted from income tax. With a purchase of NSC worth Rs. 1000 the consumption of the individual will go up by Rs. 120 if 50 per cent of his purchase is tax exempt, the tax rate at the margin 30 per cent, and the marginal propensity to consume 80 per cent[1]: the Budget document will show additional capital receipts, but investible resources of the economy have registered a decline!

The magnitude of such leakage from the total saving of the community would be substantial if people use their past savings for buying financial assets on which new fiscal concessions are granted. With a given set of concessions the effect due to portfolio adjustment will no doubt taper off over time for an individual tax payer. But the essence of development planning lies in the generation of investible resources as early as possible. Moreover, the contractionary effect on aggregate saving noted above may gain in strength as more people become liable to pay the income tax and existing tax payers move to upper income brackets[2]. Mr. Singh (like his predecessors) ignores this factor altogether when he not only retains all exemptions and other incentives granted hitherto, but also proposes to raise funds (outside the Budget) for public sector units through bonds with high coupon rates backed by substantial fiscal concessions.

The gist of our argument is fairly simple. Fiscal concessions on specified forms of saving may in fact be counter productive[3], since the tax benefits are not then on <u>net</u> savings. The National Deposit Scheme (New Series) outlined in Long Term Fiscal Policy (LTFP, pp. 27-8) also suffers from the same defect: though it seeks to relate the incentives (unlike NSC-type schemes, see fn.2) to net add not gross accumulation of deposits, still it is not net <u>aggregate</u> saving but additional holding of a particular financial asset that is sought to be promoted. Hence the necessity of moving towards a system of expenditure tax and of getting rid of the so-called fiscal incentives to saving, even though they have enabled the government to add significantly to its Capital Receipts.

This does not mean that government borrowings have nothing to contribute towards development planning. For one thing, loans from external sources does augment the investible resources of the economy. We choose, however, to ignore them for the present partly because they have been relatively unimportant compared with (direct and indirect) borrowing from the public, but largely because they give rise to problems[4] a discussion of which will take us for afield from our present concern. Borrowings from internal sources have also a key role to play when our Plans require around half of aggregate investment to be undertaken by the public sector. But then this allocative role of borrowing should not be confused with its role of resource mobilisation, especially since the former would have to be in consonance with the requirement of leaving enough resources for the private sector to fulfil its Plan target of investment[5]. The overall impact of fiscal measures on resource mobilisation is thus indicated better by the surplus on Revenue Account than by any other single figure in the Budget.

Judged by this criterion the recent performance of the Ministry of Finance has been far from satisfactory. The deficit of Rs 5940 crores (RE) on Revenue Account in 1985-86 is higher than the Budget estimate by Rs 339 crores and amounts to a little over 0.4 per cent of GDP. What is more disturbing, the current year's deficit on the same account is expected to be higher than last year's Budget and revised estimates by 33 per cent and 16 per cent respectively. Thus, contrary to the objective aired in Long Term Fiscal Policy of reducing the deficit as a proportion of GDP to 1.3 per cent in 1986-87 (LTFP, p.11, Table 3), Mr. Singh seeks (through operations on Revenue Account) to bring down the investible surplus by nearly 0.5 per cent of GDP!

Towards a direct tax holiday?

The gap between protestations in Long Term Fiscal Policy and the practice in the current Budget is no less wide in the sphere of tax structure. In LTFP (p.13) the Ministry of Finance has promised "to increase the share of direct taxes in total tax revenue over time"; in fact, the ratio of direct to indirect taxes (net of states' share) in the Union Budget is proposed to be raised from 23.8 per cent in 1985-86 (BE) to 26.1 per cent in 1986-87) and ultimately to 28.7 per cent in 1989-90 (computed from Table 4, LTFP, p.13). However Mr. Singh has now budgeted for a sharp decline in this ratio to 19.1 per cent in 1986-87 (computed from Budget at a Glance, p.2). Indeed in spite of the rhetorics in both LTFP and the Budget Speech the fact remains that the ratio of direct taxes to gross tax collections of the Centre fell from 21 per cent in 1984-85 (RE) to 19.3 per cent in 1985-86 and is expected to go down further to 18.4 per cent in the current financial year (LTFP, p.21; Budget at a Glance, p.2).

The lack of any earnest effort on the part of the government for arresting, not to say of reversing, this trend of declining importance of direct taxes is attested by this year's Budget proposals themselves. Out of the additional tax revenue of Rs 488 crores expected to be netted under these proposals only a paltry sum of Rs 21 crores will be from direct taxes. Even this figure is highly suspect since concessions to income tax payers in respect of standard deduction alone is likely to cost the Exchequer nearly 100 crores with about half of 4 million income tax payers availing of the benefit at the average rate[6]. Add to that (besides the releifs granted last year) the complete exemption of imputed income from owner-occupied houses[7], and concessions[8] granted in respect of capital gains through advancement of the date by more than 10 years (from 1.1. '64 to 1.4. '74) for determining the cost of assets, addition of new categories of assets to the exempted list and doubling of the limit for standard deduction from Rs 5,000 to Rs 10,000 - and the Finance Ministry's moaning in LTFP (p.23) on the lack of buoyancy in direc tax revenues because of "narrow coverage of the working population, numerous exemptions and deductions", etc., cannot but ring hollow. In fact, even the figures cited by us do not fully reveal the relative weights placed by the Ministry on direct and indirect taxes: our of Rs 1820 crores of additional resources slated to be raised by public enterprises during 1986-87 a substantial part will be from increases in administered prices, and their economic impact is essentially the same as that of a rise in indirect taxes.

All revenues are equal, but some are more equal than others

Our concern at the erosion of the base of direct taxation[9] is not simply on account of distributional considerations - though that should never be lost sight of in a country like ours -, but because indirect taxes are in general less effective than direct ones as an instrument of resource mobilisation. Since this perception is conspicuous by its absence in the Economic Survey, the Long Run Fiscal Polity or the Budget itself, we may as well dwell on this point for a moment.

To see most clearly the differential impact of the two types of taxes consider an economy where factor prices (in nominal terms) are inflexible in the downward direction an assumption not at significant variance with the Indian experience. In the absence of any (intra-private sector) redistribution effect resources released in real terms from additional revenue collected through direct and indirect taxes are approximated respectively by -

$$dR = c\, d\,T_i \qquad \ldots\ldots(2)$$

$$dR = c.d\,T_n . \frac{Y}{Y + d\,T_n} = c. \frac{d\,T_n}{1 + (d\,T_n / Y)} \qquad \ldots.(3)$$

where dR = additional amount of resources released measured at base prices (defined to be unity by choice of units); c = marginal propensity to consume; $d\,T_i$ = additional amount of direct tax; $d\,T_n$ = additional amount of indirect taxes; and Y = GDP at base prices. Thus for the same amount of additional revenue, resource mobilisation through taxes on commodities is less than that from taxes on incomes, and the differential impact of the two will be the greater, the larger the magnitude of additional indirect tax collections as a proportion of GDP.

Resources released through $d\,T_n$ will in fact be less than that indicated by the r.h.s. of (3) to the extent wages are linked to the cost of living index and prices are set on a cost plus basis. If money wages are adjusted by a fraction for every unit increase in the cost of living index, additional resource mobilisation through indirect taxes will be given by the new relation -

$$dR = c.\ \frac{d\,T_n}{1+ (d\,T_n/Y) \,/\, [1 - (1+\ )]}$$

where is the ratio of wage to non-wage incomes in net value added[10]. Equation (4) discloses dramatically the limits to the efficacy of indirect taxes as an instrument for raising additional resources: the efficacy is completely lost when equals or exceeds $/(1+\ )$ - a situation quite within the bounds of possibility, though we choose not to overemphasise it. The main point to note here is that when the government persistently relies on indirect taxes, inflationary expectations are built into the system of setting wages and prices, and erode thereby the resource mobilisation impact of these measures.

The above reasoning does not indicate fully the efficacy of direct taxes as an instrument of resource mobilisation for a planned economy like ours[11]. Note that most quantitative controls and restrictions as also numerous subsidies in various forms are deemed necessary primarily because of existing inequalities in income and wealth. These measures not only create distortions and widen the scope for corruption, but also eat up (in the process of their execution) a not inconsiderable amount of resources, both public and private. The drain on the investible surplus on this count can thus be greatly reduced with greater reliance on direct rather than indirect taxes.

Interest hike - in whose interest?

The trend towards demobilisation of resources through the Budget has been further strengthened by Mr. Singh through the rise in interest rates on Provident Funds and the proposed issue of bonds by public sector enterprises at very attractive rates of return. As we have argued before, there is no significant relation between interest rates and aggregate savings. Hence the proposed measures, instead of adding anything to the current investible surplus of the economy, will raise substantially the interest burden of the government sector. The captive market for government securities under the monetary arrangements in force has so far made financing of public sector investment possible at a comparatively low average interest rate of around 9 per cent (see RBI, 1985, Ch.3). This has not only been an important means of resource mobilisation (the effect of such low rates being practically the same as that of taxation of interest incomes), but has lent also an element of progression[12/] in our fiscal system, as interest earnings accrue mainly to the relatively affluent sections of the community.

Thus Mr. Singh's measures on interest and bond issue by public sector enterprises amount to an income transfer to the well-to-do at the expense of investible funds, Indeed, if all existing loans taken by the Government were to bear the proposed interest costs, the resulting magnitude of resource demobilisation would be of the order of Rs 5000 crores[13/] - a sum larger than the total food and fertiliser subsidy by Rs 1300 crores (computed from Budget at a Glance, p, 6). The all out drive of the Government to reduce costs on account of subsidies that can have an immediate impact on poverty and malnutrion, coupled with its readiness to fritter resources away for the benefit of upper and middle income groups, suggests that something is wrong with either its economic logic or social sympathies.

2. Resource Mobilisation - A Disaggregative Approach

So far our analysis has been conducted on the tacit assumption of a single commodity or of perfect substitutability (in productoon or through trade) among various goods and services. Given the limited possibility of converting one commodity into another in the short and medium runs, fiscal measures aimed [illegible] at the mobilisation of an aggregate surplus on Revenue Account are unlikely to be very effective in our economy. As we have indicated elsewhere (Rakshit, 82/83), since both demand deficiency and supply bottlenecks may operate simultaneously in different sectors in countries like India, tax measures and Plan allocations on different heads must be related to the nature of the constraints in force. Hence our overall approval of this year's larger allocations on Rural Development and related programmes the incremental demand from which is mostly for foodgrains.

Note that in the absence of any substitution possibility whatsoever between consumption and investment goods there is no necessity of taxation for mobilising investible resources. Substitution possibilities arise partly because there are goods (e.g., automobiles, refrigerators or furniture) which can be used for both consumption and investment, but mainly because the two types of goods draw on some common intermediate inputs like petroleum, transport, steel or electricity[14]. It is also important to recognise that resources required to be released depend crucially on the pattern of investment proposed to be undertaken: little will be gained by reducing the subsidy on food if we want to build a steel or a power plant (even if the cost of the plant at base prices equals the amount of subsidy withdrawn[15/]). If the above sounds like labouring the obvious, our humble submission is that the framers of the Budget appear not to have paid much attention to such simple principles. Let us elaborate.

On customs and habits of thought

Customs and habits die hard : all our Finance Ministers have followed the age old practice of relying heavily on import duties for raising revenue. In fact, in the current Budget customs are expected to contribute more than one third of the total tax revenue and as much as Rs 407 crores out of Rs 488 crores of additional amount due to new tax proposals. Now, import duties constitute an important Budgetary instrument, but we should be clear regarding the objective they are intended to serve.

In this case, as is well known, there is generally a conflict between the revenue and the protection objectives: the latter is served best when collection from this source becomes negligible, as the potential buyers of foreign goods are forced to switch over to their domestic substitutes. Though the professed objective of the Finance Minister in raising customs duties is protection of our capital goods industry, the fact that a substantial revenue gain is expected from this source suggests that the industry can expect little relief on this count, at least in the current financial year[16]. Does the measure then promote the objective of resource mobilisation? Unfortunately the answer is an unequivocal 'no', and its reason needs perhaps to be spelt out in some detail since this has an important bearing on policies relating to the structure of indirect taxes and prices administered by the government.

The clue to our answer is once again that, the overall resource mobilisation impact of a measure consists in a reduction in the consumption demand for goods that compete directly or indirectly (through their use of common inputs) with investment (or goods which the government proposes to procure). Consider then the case where the Hindustan Machine Tools pays an addttional duty of Rs 1 lakh for its import of some equipment. The current earnings of workers engaged by the company or the disposable nominal incomes of people anywhere else in the domestic sector are left unaltered by this extra revenue going to the government coffers; nor is there any attendant rise in the prices of consumer goods[17]. Hence (except for their differential impact on money supply) this source of government revenue stands on the same footing as deficit financing. (To the extent the import demand for capital goods or their components is inelastic, duties on these items do not contribute anything either towards the solution of the Balance of Payments problem). It appears that Treasurers in the olden days had had a better grasp of the basic fiscal rules than their present-day counterparts in developing countries! (Imports in those days, let us remember, consisted primarily of items of consumption and the 'Kings' expenses were also mostly on this group of commodities and services[18]).

This does not mean that duties on imported capital goods or their components have no role to play in a country like ours. Apart from rendering protection to fledgling units or to industries operating with excess capacity, such taxes can be used to discourage investment in particular sectors of the economy (or in particular forms). If we want HMT to cut down its scale of investment, duties on its imports may do the trick; but we should not delude ourselves with the belief that all collections from customs provide a non-inflationary source of financing government expenditure.

Indirect taxes and administered prices

The above line of reasoning may easily be extended to locate the resource mobilisation effect of indirect taxes and of an increase in prices of public sector enterprises. To the extent these measures raise the cost to investors, there is no addition whatsoever to the aggregate investible resources of the economy[19]. (In fact if bonus or money wages in public sector enterprises are linked partly to profits, the price increase will make a negative contribution towards resource mobilisation).

The salutary effect of the measures under consideration can come about only through a rise in prices to the consumers, and not to the investors[20/]. Hence in the Indian context equations (3) and (4) do not yield a satisfactory measure of resource mobilisation from indirect taxes. If we ignore partial indexation of money wages and distinghish between only consumption and investment goods, resources released by the additional collection of indirect taxes will be given roughly by -

$$dR = \frac{\lambda . d\ T_n}{1+(\lambda . dT_n/C)} \qquad \text{......... (5)}$$

where λ = fraction of additional taxes realised from the purchase of consumption goods, and C = value of consumption goods at base prices (taken to be 1 by the choice of units). This, however, indicates the amount of consumption goods released; the rise in investible surplus, dR_i, would then be -

$$dR_i = \frac{\lambda \delta\ d\ T_n}{1+(\lambda . d\ T_n/C)} \qquad \text{........(6)}$$

where δ is the rate of substitution at the relevant margin of investment goods for consumption articles[21/].

Equation (6) points to two of the basic weaknesses of our fiscal system. First, the incidence of most indirect taxes and hikes in administered prices falls more on investment than on consumption goods. Even if, in the absence of detailed data, we are forced to turn conservative and assume the incidence on the two types of goods to be in proportion to their share in GDP, we come up with a staggering figure of around Rs 6150 crores as constituting an overestimate[22] (from an economist's point of view) of the Union Government's receipts on Revenue Account in the 1986-87 Budget[23].

Second, to the extent is small - i.e., indirect taxes or the rise in administered prices reduce the consumption of commodities and services that do not compete significantly with investment goods for their inputs -, there is not much addition to the investible surplus in real terms. Thus consumers should be forced to pay more for (or rather, to curtail their consumption of) electricity, automobiles, refrigerators, petroleum products or steel furniture, and concessions granted by Finance Ministers to relatively affluent housewives on such items run counter to the canons of even intergenerational distributive justice.

Distributive justice, intra- and inter-generational

What of the burden imposed on the 'common man' by the rise in prices of consumer goods? Needless to say, justice demands that price increases should as far as possible be confined to those goods which figure more in the rich than in the poor man's menu. Fortunately there is no conflict at this stage of our economy between intra-and inter-generational distributive justice, since it is the goods consumed by the rich that can be more easily transformed into investment.

This really is an extension of the principle laid down in Long Term Fiscal Policy itself: "Imports of non-essential consumer goods will continue to be banned" (LTFP, p.42). This is a sound policy measure in view of the foreign exchange constraint faced by our economy. But let us note that production of these non-essential goods for domestic consumption constitutes no less a drain on our scarce investible resources: if we ban the import of passenger cars on the ground that they are non-essential consumer goods, justice (allied with economic logic) demands that we should not fritter our steel, fuel, transport, engineering skill and foreign exchange away in trying to produce them in the domestic sector.

The policy prescription suggested above is, as the perceptive reader must have realised, only a second best alternative. Money is said to burn holes in people's pockets: if the rich are deprived of one source of consumption, they are sure to find new ways of satisfying their needs[24]. Hence we come full circle and are made to realise once again the cardinal importance of securing an equitable distribution of income - through income transfers by way of direct taxes and provision of gainful employment to the indigent.

3. On jobs, Means and Ends

We propose in this connection to confine ourselves to only those aspects of Mr. Singh's Budget which appear to have an immediate bearing on the problem of unemployment. There are three sets of Budget proposals that are addressed directly to this prblem: the first relates to protection of the capital goods industry through higher import duties on these items (Budget Speech, p.41); the second to the substantial increase in Plan allocation on Rural Development and employment generation programmes (Budget Speech, pp.14-6); and the third to the growth of small scale industries (Budget Speech, p.31).

We have already noted the rather limited protection effect that the rise in import duties on capital goods is likely to have. What is required here is an identification of (sub)sectors facing the demand constraint and a corresponding adjustment of our investment programmes keeping the ultimate objectives of planning in view. If production of certain types of capital goods is judged (after a careful balancing of pros and cons) wasteful in the long run, further investment in these lines of production should be discouraged; but it will be foolish, in a capital poor economy like ours, not to make the best of even bad investment already made.

The enlarged programmes of employment generation in rural areas are by far the most attractive feature of Mr. Singh's Budget (and as we have observed, they are also the least costly in real terms). However, in order that the programmes do not degenerate into a scheme of providing doles or of merely extending political patronage, the machinery for their administration needs to be strengthened and their impact in physical terms monitered. Otherwise there is every danger that employment thus provided would never be self-sustaining. The danger is enhanced when these activities are not carefully integrated with plans relating to Agriculture, and Irrigation and Flood Control. It is for this reason that one can question the efficacy of a policy that provides for a large increase in Plan allocation under Rural Development along with a cut in that for Agriculture, and Irrigation and Flood Control (Plan Budget for 1986-87, pp. 40-2).

Finally for the promotion of small scale industries. Space prevents us to go into any detail the economics of the measures proposed; but there are some fairly clear points that may perhaps be reiterated in this context. First, the necessity of providing reliefs to small scale units on almost a permanent basis highlights the failure of the government policy on other fronts, especially of measures relating to finance, marketing and infrastructural facilities in general and provision of rationed inputs in particular[25]. Fiscal concessions to these industries may be necessary, or even imperative, for attaining employment or other objectives in the short and medium runs, but the best policy in the long run is to evolve suitable institutional structures that do not put the small units at a disadvantage. The reason is that, otherwise, the resource cost of production and administration of the schemes of concession would be high and limit thereby both growth and the generation of productive employment in the economy as a whole.

Second, while lowering the excise duties under the New Scheme of Excise Concessions for small scale firms, the Finance Minister has also doubled the limit of turnover (from Rs 75 lakhs to Rs 1.5 crores) beyond which the units will lose these advantages ("to ensure that the scheme of concessions is a ladder and not a lid", Budget Speech, p.31). But the employment objective may be defeated if the provision of ladder to the relatively large enterprises within the group puts hurdles to the entry of new ones. Hence concessions are required to be related to the scale which is deemed to contribute most to our goals of employment or equity, and not to some ad hoc figure for annual turnover.

Again, turnover may not be a bad index of size of units within a particular industry. But there is no economic rationale behind fixing the same amount of turnover for concessional treatment for all firms because, first, their ratio of value added to total sales varies widely across industries, and second and more important, the optimum scale (as defined above) is not the same in different lines of production.

The necessity of discriminating between different industries within the small scale sector is reinforced by another consideration - a consideration that has formed almost a refrain of the present paper. In the process of giving subsidy to all goods produced in this sector we may often promote the production and domestic consumption of items of luxury consumption. The argument that their production generates employment suffers from the fallacy of composition, since it (the argument) ignores the overall constraint on employment (as also on welfare programmes) in a planned economy.

In such an economy the basic economics of employment, eradication of poverty and growth is fairly simple: all non-essential consumption is a drain on nation's resources and limits the attainment of these three major objectives of our planning. A fiscal system based on the high principle of distributive justice can thus go a long way in securing the purely material goals we have set before us.

FOOTNOTES

1/ Note that in this case the net private saving has risen by Rs 30 (which has been assumed to be held in other forms), but saving on the Revenue Account of the government falls ceteris paribus by Rs 150. Hence the decline in aggregate saving to the tune of Rs 120. For a complete treatment of the problem we require to consider dB itself as a decision variable. But the fact that remains that since the fiscal concession permits the individual to raise both consumption and saving out of a given level of income, the aggregate saving of the economy will fall due to leakage of tax revenue.

2/ In fact for relatively short-term financial assets like NSC fiscal concessions may be obtained many times over simply through repurchase on their maturity (as and when they become eligible for encashment).

3/ Though they may often be supported for attaining objectives other than that of resource mobilisation. Thus, inducing people to take out life insurance policies is eminently justified when there is an imperfect appreciation of the imperative necessity of risk aversion in matters concerning life and death.

4/ On which many a development economist have written at length. Fortunately these problems are not for the moment as serious for India as they are for most Third World countries.

5/ A discussion on suitable instruments for allocation of the investible surplus of the economy is postponed for a future occasion.

6/ Dr. A. Bagchi made this point to me, though the basis of his estimate and the sum mentioned were perhaps different and more accurate.

7/ Thanks to Mr. Singh, a person owning a house and earning a taxable income of Rs 10,000 a month can now generally look forward to a net increment in his yearly income by Rs 8,000. Note also that since 1982-83 while wholesale prices have risen by 22 per cent and the consumer price index for urban non-manual workers by 21.5 per cent, the limit for standard deduction is proposed to be raised by 66.7 per cent.

8/ The post-Budget fall in share prices can partly be ascribed (apart from the lack of any institutional support) to the tax payers' attempt to avail of these concessions. In the process even if there is a rise in tax collections, additional consumption out of capital gains reduces the investible surplus of the economy and provides yet another example of resource demobilisation through the Budget.

9/ What of the Finance Minister's claim of the 'soundness' of the strategy of increasing yields through lower rates - a policy that is said to have been extremely effective last year (Budget Speech, p.3)? As the document on LTFP (p.22) reveals, there was in fact a secular decline in income tax collections as a proportion of GDP since 1971-72 even though the maximum marginal tax rate was brought down over a twelve-year period from 97 per cent to 61.5 per cent. Hence last year's revenue gains under this head could wholly be attributed to widespread and persistent raids carried out by the Income Tax Department and may thus be said to lend support to the rather cynical view of the classicists that the source of honesty is the fear of gods or of authorities. Be that as it may, our observations are based on figures supplied by the Ministry of Finance itself which has presumably allowed for the salutary effects of low tax rates in the Budget estimates. Note also that ceteris paribus an upward revision of standard deduction does not affect for most people the propensity to disclose true earnings, but reduces their work effort through the income effect!

10/ Since $dw = \alpha\, dp$, and $dp = \frac{(1+\beta)dw}{\beta} + \frac{d\,T_n}{Y}$ where dw is the rise in money wage costs per unit of output.

11/ Does the redistributive effect of direct taxes runs counter, _a la_ the classical argument, to their effect on resource mobilisation? As has widely been observed, in an emulative society these two effects reinforce, rather than go against, each other.

12/ Though this effect was considerably weakened by numerous exemptions to income tax payers. Note that our conclusion goes through so long as the distribution of interest incomes _for the entire population_ is more unequal than that of incomes from other sources - a fairly weak condition in view of the fact that the proportion of interest to wage incomes is negligible for people in low income groups,

13/ Our figures here are suggestive, rather than definitive, To the extent government securities are held by commercial banks or other financial institutions in the public sector, the net leakage per unit of loan will be represented roughly by the difference between the rates proposed and that paid to the public on their deposits. No such adjustment is required for "small savings" and government securities held by private financial institutions. Hence the rise in interest cost on the average will be around 5 per cent.

14/ We have not mentioned the universal factor, labour, since, first, instances of non-availability of extra labour limiting the level of production can be safely ignored for the Indian economy; second, the lag between a cut in production and retrenchment is considerable; and third, the process of absorption of labour thrown out of job in one sector into another sector is time-consuming.

15/ The basic point to note here is that this sum should represent command over extra resources in real terms adequate to produce (or procure from abroad) the machinery, equipment and other inputs required for the plan.

16/ And the problem of capacity utilisation, let us note, is a short-term one, arising as it does from the currently prevailing domestic and international demand conditions.

17/ If the HMT subsequently raises the prices of its products, its effect can be measured in exactly the same manner - by looking into the consequent changes in disposable income and prices of consumption goods.

18/ This is apart from the fact that under the bullion standard prevalent in those days a larger tax collection always represented a greater command over resources, domestic or foreign.

19/ Only a larger amount of funds in nominal terms will now be required to keep investment in real terms unchanged.

20/ We ignore here substitution possibilities among inputs, which anyway is a long term possibility and is related to the choice of technique problem.

21/ Note that δ is generally less than 1 even though the base prices of all goods are assumed to be one.

22/ This is perhaps an underestimate of the extent of 'overestimate', since our figure is obtained without taking account of profits of public enterprises and the wage-push effect of price increases, a la equation (4)

23/ Computed from data given at Budget at a Glance (p.2) with the assumption that gross investment will be 25 per cent of GDP.

24/ The argument does not hold to the extent their disposable income is reduced through payment of indirect taxes. Also, there is not 'much' harm if they can satisfy their 'needs' without drawing on resources required for investment or essential consumption - an extremely stringent condition indeed.

25/ The force of the argument is strengthened by the fact that small scale firms have a clear advantage in respect of wage costs.

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