CHAPTER 6

FISCAL POLICY AND GOVERNMENT BUDGET

The year 1985-86 has been noteworthy for a number of developments which will have a long term impact on the fiscal and budgetary policies of the Government. The year saw the finalisation of the Seventh Five Year Plan, covering the period 1985-90, and the formulation of a Long Term Fiscal Policy for the first time. A new direction was given to tax policy in the 1985-86 Budget, which resulted in tax revenues outstripping, by a wide margin, the Budget expectations. Another noteworthy fiscal development was the strict adherence by States to the policy relating to unauthorised overdrafts with the Reserve Bank. The States were put on alert and advised that the Reserve Bank would stop payment on behalf of a State Government if the overdraft emerged in the State Government account and continued for more than seven consecutive working days. The Seventh Plan casts a major responsibility on the public sector to mobilise resources for financing the Plan. 1985-86 is the first year of the Seventh Five Year Plan and the array of policy initiatives undertaken and proposed will have their full impact in the remaining years of the Plan and beyond.

Seventh Five Year Plan

6.2 The Plan postulates growth in Gross Domestic Product (GDP) at factor cost of five per cent a year in real terms. This is in line with the growth rate achieved in the Sixth Five Year Plan and somewhat higher than the average for the past decade. The process of economic growth and the Government's anti-poverty programmes have already reduced the incidence of poverty substantially. The development strategy of the Seventh Plan and the pattern of growth emerging from it are expected to lead to a further sizeable reduction in the poverty ratio from about 37 per cent in 1984-85 to about 26 per cent by 1989-90.

6.3 The Seventh Plan provides for a total outlay of Rs. 3,48,148 crores at 1984-85 prices, of which Rs. 1,80,000 crores is expected in the public sector. Excluding current outlays in the public sector of Rs. 25,782 crores, the total investment envisaged aggregates to Rs. 3,22,366 crores. This is to be financed by domestic savings of Rs. 3,02,366 crores and net inflow of funds from abroad of Rs. 20,000 crores. Thus, nearly 94 per cent of the total investment is expected to be financed from domestic resources.

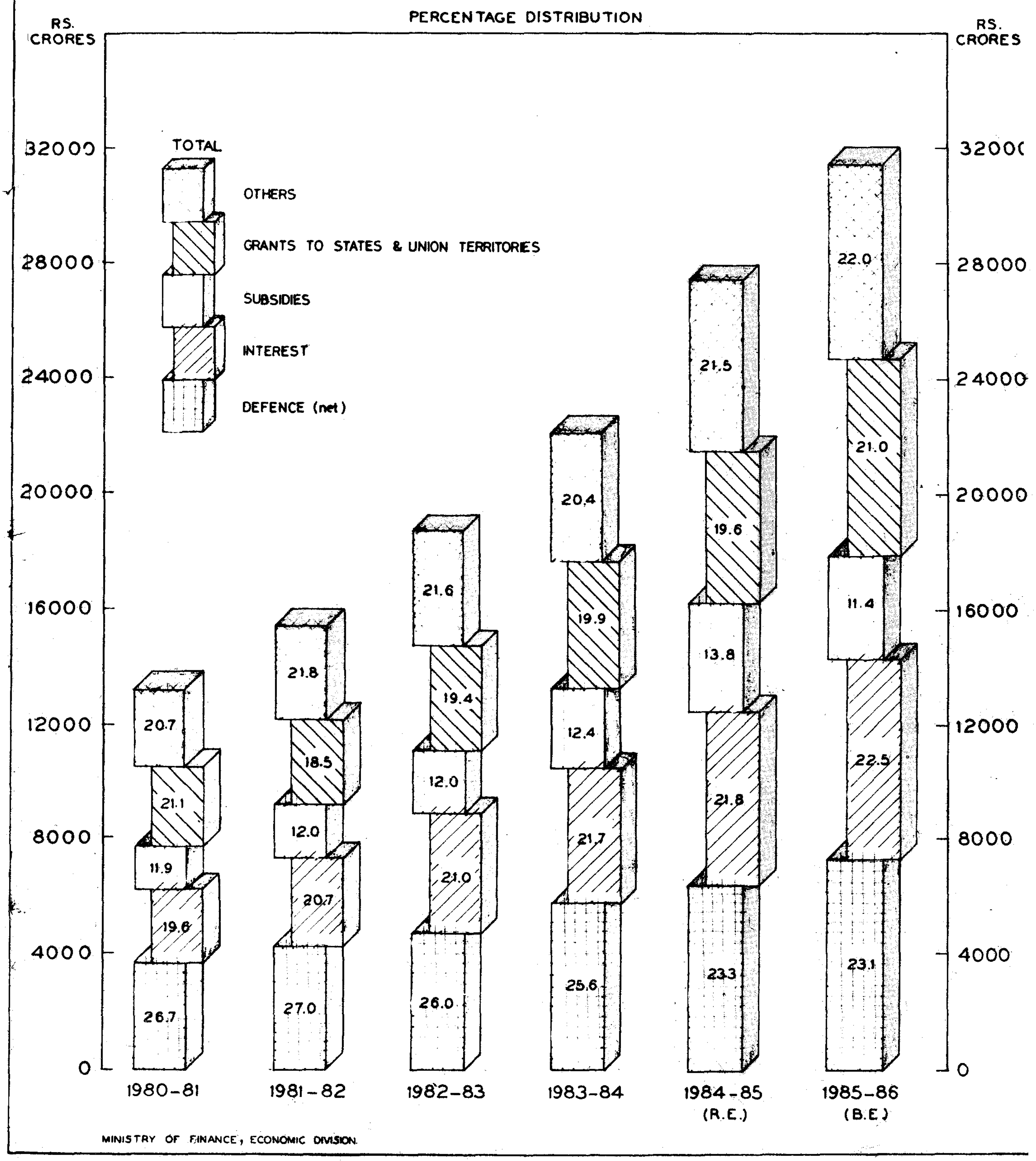
6.4 The aggregate outlay of Rs. 1,80,000 crores is expected to be financed to the extent of Rs. 1,03,298 crores (57.4 per cent) from domestic budgetary resources at 1984-85 rates of taxation and prices, and Rs. 44,702 crores (24.8 per cent) by fresh measures of additional resource mobilisation. Net capital inflow from abroad for the public sector plan is estimated at Rs. 18,000 crores (10 per cent), while the balance, i.e. Rs. 14,000 crores (7.8 per cent) is to be met through deficit financing. The Seventh Plan places a major responsibility on public sector enterprises for resource mobilisation. Taking the Centre and State enterprises together and allowing for their share of additional resource mobilisation, public sector enterprises are expected to contribute nearly Rs. 59,000 crores during the Seventh Plan period. The total resources to be deployed by the Central Government for financing the Plan are estimated at Rs. 1,29,039 crores, with the States bearing the responsibility for Rs. 50,961 crores. Central assistance for State Plans is estimated at Rs. 29,737 crores. This will enable the Centre (including the Union Territories) and the States to finance total Plan outlay of Rs. 99,302 crores and Rs. 80,698 crores respectively.

Long Term Fiscal Policy

6.5 For the first time in India's history the Government formally presented a Long Term Fiscal Policy (LTFP) to Parliament on December 19, 1985. In doing so, the Government fulfilled the commitment given in the Budget speech for 1985-86. The LTFP, which has been conceived as an instrument to serve the basic objectives of the Seventh Plan, marks a new approach to fiscal management of the economy.

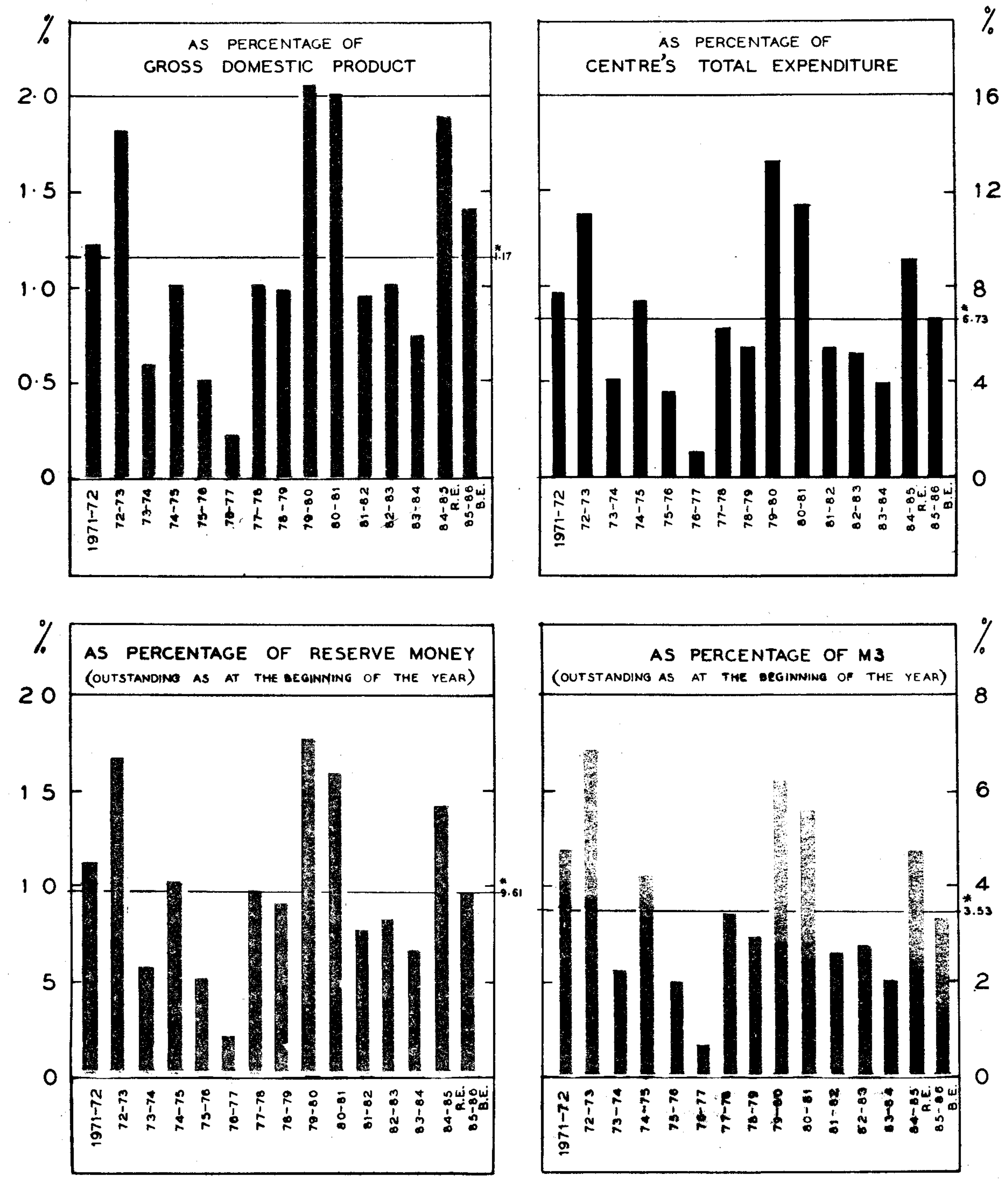
6.6 Important benefits are anticipated from this explicit long term perspective to the framing of fiscal policy. It is expected to impart a definite direction and coherence to the sequence of annual budgets and this

CENTRE'S REVENUE EXPENDITURE



GMDIPMRND-PLW-469/2/Fin/85-86...Chart 14

CENTRE'S BUDGETARY DEFICIT



*AVERAGE FOR THE PERIOD 1971-72—85-86

MINISTRY OF FINANCE, ECONOMIC DIVISION.

should bring about a greater degree of predictability and stability in the economic environment. Second, the LTFP will accord a greater role for rule-based fiscal and financial policies and less reliance on discretionary, case-by-case administration of physical controls, an evolution in economic management demanded by our increasingly complex economy. Third, the LTFP will facilitate effective co-ordination of different dimensions of economic policy. Finally, the LTFP is expected to strengthen the operational linkages between the fiscal and financial targets of the Seventh Plan and the annual budgets.

Financial Framework

6.7 Several salient points emerge from an analysis of the historical pattern of financing the Plan resources deployed by the Central Government and the indicative year-wise phasing of the financing pattern for the Seventh Plan period (Table 6.1). First, as in the past, the overwhelming bulk of the resources for financing development will continue to come from domestic resources, with inflows from abroad playing a modest supporting role. Second, if the Seventh Plan is to be financed in a non-inflationary manner, it is imperative that the surpluses generated by the public sector increase substantially and there is correspondingly less reliance on borrowed funds, especially from the banking system. This, in turn, highlights the need to moderate the growth of non-Plan expenditures, enhance the built-in revenue-raising capacity of the tax system and ensure that the public sector undertakings generate higher surpluses necessary to finance the Plan.

TABLE 6.1

Projections for Financing of Central and Union Territories' Plans and Assistance for State Plans over the Seventh Plan period
(As per cent of GDP at 1984-85 prices)

	1985-86 (BE)	1986-87	1987-88	1988-89	1989-90	Seventh Plan Period
1. Centre's Resources for the Plan	**10.2**	**10.1**	**10.1**	**10.1**	**10.1**	**10.1**
(a) Central Plan	7.5	7.5	7.5	7.5	7.5	7.5
(b) Union Territories' Plans	0.3	0.3	0.3	0.3	0.3	0.3
(c) Assistance for State Plans	2.4	2.4	2.3	2.3	2.2	2.3
Financed by :						
2. Net Capital Inflow from Abroad*	**1.2**	**1.3**	**1.4**	**1.5**	**1.6**	**1.4**
3. Domestic Borrowings	**6.4**	**5.6**	**5.0**	**4.4**	**4.2**	**5.1**
(a) Market borrowings	2.1	1.6	1.5	1.5	1.5	1.6
(b) Budgetary deficit	1.3	1.2	1.1	1.0	0.9	1.1
(c) Others	3.0	2.8	2.4	1.9	1.8	2.3
4. Public Savings	**2.5**	**3.2**	**3.7**	**4.3**	**4.3**	**3.6**
(a) Balance from current revenue (BCR)**	—0.4	—0.2	Neg.	0.3	0.2	Neg.
(b) Internal and extra-budgetary resources of Public Sector Undertakings	2.9	3.4	3.7	4.0	4.1	3.6

*Including external commercial borrowing.

**BCR figures here differ from those in the Seventh Plan document on account of inclusion of subsidy on imported fertilizer as non-Plan revenue expenditure and exclusion of payment to the Oil Industry Development Board from such expenditures. Corresponding adjustments have been made in other relevant heads of financing.

Note : Totals may not add up due to rounding. These projections are based on the Seventh Plan's target for growth of five per cent per year in GDP at factor cost.

6.8 Within the financial framework summarised above, the LTFP indicates the direction of change in tax policy that will be required to promote growth, increase the built-in elasticity of the tax system, secure better tax compliance and move towards a more equitable distribution of the burden of financing the Plan.

Direct Taxes

6.9 The 1985-86 Budget introduced major reforms in direct taxes to foster an environment for growth, productivity and saving, while providing relief to lower income groups. These reforms (described in detail in a subsequent section), together with the measures taken to strengthen tax administration and enforcement, have already yielded substantial dividends. The Centre's collections from direct taxes in the first ten months of the current financial year recorded an increase of about 24 per cent over collections in the corresponding period of the previous year.

6.10 In order to promote stability in the economic environment and thereby encourage savings, investment and growth, the LTFP has announced the Government's intention to keep the present rate schedules for taxes on personal income and wealth unchanged for a minimum period of five years. Recognising that inflation progressively increases the effective rate of taxation for given levels of real income and wealth through the process of "bracket creep", the Policy has provided for review of tax brackets every two or three years. To further simplify the administration of direct taxes, the direct tax laws are to be rewritten, with a draft bill incorporating the necessary amendments expected by June, 1986.

6.11 To strengthen the incentive for savings, the LTFP proposes a new investment instrument, the National Deposit Scheme (New Series). As this is a novel scheme, the Government has invited the views of the public before taking a final decision. Deposits under this new scheme will be eligible for deduction from taxable income to the extent of 50 per cent of the net deposit made in a year. The net withdrawals of a year will be added to the taxable income of the year to the extent of 50 per cent. Deposits will carry interest at ten per cent per annum but the interest will not be eligible for the concession currently available to interest on bank deposits under Section 80L of the Income Tax Act. By relating tax concessions to net saving, the proposed new scheme will be moving some way towards an expenditure tax concept. The Government has also set up a committee for examining the feasibility and desirability of moving further towards an expenditure tax.

6.12 On the grounds of both equity and as a check against attempts to reduce tax liability to income and wealth taxes via the medium of gifts, the LTFP has indicated that the Gift Tax will continue to be levied. However, the Government will review the provisions with a view to rationalising them, with particular consideration to enhancing the exemption level to take account of the effect of increases in prices since the present exemption limit was fixed.

6.13 As regards Capital Gains taxation, the LTFP notes that the Government will undertake a review to make capital gains taxation more effective and promote investment in desired channels. Meanwhile, the date for revaluation of assets acquired long ago, for purposes of computation of capital gains, will be advanced by ten years to April 1, 1974. Second, whereas a fraction, ranging from 25 per cent to 60 per cent, of long term capital gains is permitted to be deducted from the tax base for non-corporate assessees, the LTFP indicates that there will be only two rates for deduction, namely, 50 per cent for gains from real estate and 60 per cent for other assets. Further, investment in bonds issued by the Industrial Development Bank of India (IDBI) and the Housing and Urban Development Corporation (HUDCO) will also be made eligible for exemption of capital gains under Section 54E of the Income Tax Act.

6.14 The 1985-86 Budget had also initiated a process of reform of the corporation tax. In his Budget speech, the Finance Minister had outlined alternative paths for further reform and had invited reactions from the public. After considering the suggestions, the LTFP has announced that companies will be allowed to deduct upto 20 per cent of their profits from their taxable income provided the amounts are deposited with IDBI and other institutions which the Government may notify. Deposits will earn interest at ten per cent per annum and will be utilised only for the purpose of investment in plant and machinery and other specified purposes. Withdrawal for any other purpose will entail taxation as part of the income of the year of withdrawal. The new scheme will come into operation with effect from the assessment year 1987-88. The Investment Allowance is to be withdrawn with effect from April 1, 1987. Furthermore, the surcharge and surtax for companies will be abolished from the assessment year commencing from April 1, 1987. After the withdrawal of the Investment Allowance, the minimum tax provision, Section 80VVA, in the Income Tax Act will be abolished. The depreciation provisions are also to be drastically simplified to provide for only two or three effective rates of depreciation.

6.15 With regard to the problem of tax evasion and black money, the LTFP proposes to continue the Government's strategy of combining reasonable tax rates and simplified procedures with better administration and enforcement in order to ensure much greater tax compliance. The specific measures mentioned in the LTFP to combat evasion include the progressive shift towards scrutiny of a stratified random sample of tax returns instead of trying to scrutinise all returns, the plugging of loopholes in the law which hinder effective prosecution of tax evaders through incorporation of certain provisions in the direct tax laws similar to those already existing in the Customs Act and the Gold Control Act and extension of special courts for speedy trial of economic offences, including tax evasion.

6.16 Furthermore, in order to tackle the problem of gross undervaluation of immovable properties, the LTFP proposes to confer a right of pre-emption to the Government to acquire any property, undergoing a transfer, at a value 15 per cent above the price or consideration stated in the transfer deed. This provision will be limited initially to metropolitan towns and also for properties worth more than Rs. ten lakhs. Selection will be based on a system of random sampling.

6.17 With regard to non-resident Indians the present tax structure is to be kept stable for five years. The Income Tax Department will take special care to ensure that all procedural irritants are minimised.

Indirect Taxes

6.18 The proposed reforms in the structure of customs and excise duties are designed to further the basic objectives of economic growth, equity, simplicity and built-in revenue-raising capacity. In addition, these reforms are intended to serve as vehicles for progressively moving from discretionary, quantitative restrictions and physical controls to non-discretionary fiscal instruments in managing the economy.

6.19 The LTFP has announced major reforms in Central Excise Taxation. First, after harmonisation of the tariff classification with the customs nomenclature, measures are being taken to reduce the number of effective rates. An important consequence of the revised classification is that the commodities falling in the residuary Item 68 of the Excise Tariff are being grouped along with other commodities in appropriate sections. Second, the Government intends to implement a modified system of value added taxation, "MODVAT" in short. The basic idea is to tax final products and not the inputs that go into production. This should reduce the distortionary effect on production and thus increase the competitive strength of Indian industries, minimise the problem of tax "cascading", and facilitate tailoring excise duties in such a manner that the well-off bear a higher proportionate burden than the poor. 'MODVAT' will be introduced in a phased manner with progressive expansion of the provisions for set-offs for excise and countervailing duties paid on inputs. The resulting loss of duty on inputs will be recouped through higher taxation of final products.

6.20 An established feature of our excise duty structure is the concession schemes for small-scale producers. The fiscal policy will continue to encourage growth of small scale units through excise concessions. The Government will reform the present scheme of excise concession in the light of the recommendations of the recently submitted report of Technical Study Group on Central Excise Tariff.

6.21 To eliminate the blocking of large amounts of excise and customs revenue in litigation, the Government will establish an Appellate Tribunal under Article 323B of the Constitution to deal with all issues related to the levy of customs and excise duties. The procedures of the Tribunal would be designed to ensure speedy settlement of revenue disputes. The present system of duty drawback will also be simplified by operating the scheme on the basis of industry rates and eliminating the option of brand rates. In order to encourage export production, the Government intends to err on the side of generosity in assessing the average drawback rates that could be applied to each industry.

6.22 The LTFP recognises that though *ad valorem* duty rates are favoured on economic considerations, problems of evasion and related administrative exigencies often require the substitution of specific duty rates for *ad valorem* ones. To ensure that revenue yields from specific duties keep pace with inflation, the Policy proposes that specific rates should be periodically revised upwards in the light of price increases.

6.23 The basic thrust of Customs Tariff reform will be to place increasing reliance on tariffs to regulate imports and progressively reduce the role of quantitative restrictions. This should increase revenues, moderate unduly high protection provided by quantitative import restrictions to certain industries and reduce the delays and uncertainties associated with the administration of import licensing. At the same time, the Government proposes to reduce the enormous multiplicity of nominal and effective rates of protection conferred by the customs tariff structure. The basic idea is to gradually move towards a two-tier structure of customs duties for capital goods, raw materials and components, though an even lower duty rate for certain "universal intermediates" used in a large number of industries is also envisaged. This structure is to be phased in gradually. For some industries a higher duty structure, with similar differentials may be necessary, with a gradual phasing down to the normal pattern over a period of years. The LTFP also envisages that the categories of project imports, for customs duty purposes, will be progressively reduced.

TABLE 6.2

Budgetary Transactions of the Central and State Governments and Union Territories

(Including extra-budgetary resources of public sector undertakings for financing their plans)

(Rs. crores)

	1980-81	1981-82	1982-83	1983-84	1984-85 (BE)	1984-85 (RE)	1985-86 (BE)
I. Total Outlay	**36845** (28.9)	**43738** (29.7)	**52747** (32.0)	**60829** (31.4)	**68916** (32.3)	**73215** (34.3)	**80326** (n.a.)
(*a*) Developmental	24426	28653	33591	39274	45104	48003	51501
(*b*) Non-developmental	12419	15085	19156	21555	23812	25212	28825
II. Current Revenue	**24563** (19.3)	**30425** (20.6)	**35795** (21.7)	**40989** (21.1)	**47593** (22.3)	**47821** (22.4)	**54213** (n.a.)
(*a*) Tax revenue	19844 (15.6)	24142 (16.4)	27242 (16.5)	31525 (16.3)	35432 (16.6)	35994 (16.9)	40241 (n.a)
(*i*) Direct taxes	3268	4133	4492	4907	5070	5462	5589
(*ii*) Indirect taxes	16576	20009	22750	26618	30362	30532	34652
(*b*) Non-Tax revenue	4719	6283	8553	9464	12161	11827	13972
III. Gap (I—II)	**12282** (9.6)	**13313** (9.0)	**16952** (10.3)	**19840** (10.2)	**21323** (10.0)	**25394** (11.9)	**26113** (n.a.)
Financed by :							
(*i*) Domestic capital receipts	7161	9493	13012	16094	16973	17442	20058
(*ii*) Net external assistance	1670	1301	1591	1611	2011	2075	2426
(*iii*) Budgetary deficit	3451 (2.7)	2519 (1.7)	2349 (1.4)	2135 (1.1)	2339 (1.1)	5877 (2.8)	3629 (n.a.)

Notes : (*i*) For clarification regarding the scope of some items in this Table, see footnotes to Table 2.1 in the Statistical Appendix.
(*ii*) Figures in brackets are percentages of GDP at current market prices.

6.24 To evaluate the tax system from the viewpoint of equity, the LTFP has called for comprehensive and independent studies of the incidence of indirect taxes and subsidies every three years or so, to be conducted by the National Institute of Public Finance and Policy.

Budgetary Developments in 1984-85

6.25 Budgetary transactions of the Central and the State Governments and Union Territories registered a record deficit in 1984-85. The year's budgetary deficit at Rs. 5,877 crores, according to the revised estimates, was more than twice the size of that year's budget estimates. As a proportion of GDP, however, the budgetary deficit was 2.8 per cent†, about the same as in 1980-81, but substantially higher than the average of 1.4 per cent for the last three preceding years. 1984-85 was the last year of the Sixth Plan and there was a marked step-up in Plan outlays during the year. Total development expenditure, including Plan and non-Plan, increased by 22.2 per cent in 1984-85 (RE), while the growth in non-developmental expenditure was somewhat lower (17 per cent), despite the increase of 28 per cent in interest payments.

6.26 Current revenues of the Centre, States and Union Territories showed an overall increase of 16.7 per cent in 1984-85 (RE). While tax revenues went up by 14.2 per cent, the growth in non-tax revenues, inclusive of the internal resources of the non-departmental undertakings, was as high as 25 per cent. In tax revenues, the growth in customs duties was the highest (27.2 per cent). The tax-GDP ratio, which had declined from 16.5 per cent in 1982-83 to 16.3 per cent in 1983-84, again picked up and reached a level of 16.9 per cent in 1984-85 (RE).

†Since the actual budgetary deficit is likely to be less than the revised estimates, this ratio is estimated to be no more than 2.4 per cent of GDP.

6.27 The gap between total expenditure and current revenues of the Centre, States and Union Territories was estimated at Rs. 25,394 crores in 1984-85(RE) and was financed to the extent of 69 per cent by domestic capital receipts and eight per cent by external assistance. Under domestic capital receipts, small savings showed a substantial increase from Rs. 2,409 crores in 1983-84 to Rs. 3,300 crores in 1984-85 (RE). The remaining gap of 23 per cent was met through budgetary deficit.

6.28 The deterioration in the budgetary position during 1984-85 took place in the case of both the Central and State Governments. The Centre's budgetary deficit for 1984-85, which was put at Rs. 1,773 crores at the budget estimate stage, rose to Rs. 3,985 crores in the revised estimates. This deterioration was on account of a number of factors, particularly a sharp increase in the subsidies, from Rs. 3,200 crores in the budget estimates to over Rs. 4,400 crores in the revised estimates. The steepest increase occured in fertiliser subsidy (from Rs. 1,048 crores to Rs. 1,832 crores) followed by food subsidy (from Rs. 850 crores to Rs. 1,100 crores). Net transfers to the States and Union Territories also increased by Rs. 1,490 crores in the revised estimates, compared with the provision of Rs. 13,532 crores in the budget estimates. Interest payments and defence expenditures also moved up by Rs. 390 crores and Rs. 375 crores respectively.

6.29 As regards the State Governments, their budgets for 1984-85 had envisaged a deficit of Rs. 565 crores, but according to the revised estimates, it had gone up to Rs. 1,892 crores. (Later data, however, indicate that the States' actual budgetary deficit was lower at Rs. 1,360 crores). The main factors responsible for this outcome were growth in expenditure, both developmental and non-developmental, beyond the budgeted levels. There were sizeable increases on account of interest charges, administrative services, relief for natural calamities, social security and welfare schemes. On the developmental side, large increases were recorded under education, medical and public health, agriculture etc. There was also a steep decline in the internal resources of the States' commercial undertakings, namely, State Electricity Boards and State Road Transport Corporations.

Central Government Budgetary and Fiscal Developments—1985-86

The 1985-86 *Budget*

6.30 The 1985-86 Budget ushered in major reforms in the rate structure of income-tax. In the case of personal income taxation, the number of slabs was reduced from nine to five. The rates of income-tax were lowered. The exemption limit for taxation of personal income was raised from Rs. 15,000 to Rs. 18,000 and the levy of surcharge on personal income-tax was abolished. These measures provided relief to the taxpayers belonging to all levels of income. With the reduction in the rates of income-tax, the maximum marginal rate came down from 61.875 per cent to 50 per cent. The Compulsory Deposit (Income Tax Payers) Scheme, 1974 was abolished.

6.31 Under the wealth-tax, the basic exemption limit for individuals and unspecified Hindu Undivided Families was raised from Rs. 1.5 lakhs to Rs. 2.5 lakhs. Under the new rate schedule, a *nil* rate slab was provided for net wealth upto Rs. 2.5 lakhs. The maximum marginal rate was lowered from five per cent to two per cent. The rate structure applicable to specified Hindu Undivided Families was also restructured. Separate limits for exemption from wealth-tax available for one house and specified financial assets were replaced by a consolidated exemption limit of Rs. five lakhs.

6.32 Income tax reliefs and concessions were also provided to promote certain priority objectives. For the benefit of industrial and other workers, the monetary ceiling on the exempt amount of retrenchment compensation received by them was raised from Rs. 20,000 to Rs. 50,000. The retrenchment compensation paid under schemes approved by the Central Government was made fully exempt from tax. The provision relating to the tax on perquisites represented by interest-free loans or loans at concessional rates of interest provided by employers to salaried tax payers was repealed. The period of concession in regard to the availability of deduction of 25 per cent of income by way of royalty, copyright, fees, etc. to the authors of university level text books, dictionaries, etc. in Hindi and other Indian languages was extended further by five years. To provide encouragement for indigenous scientific research the lump sum consideration received by scientists for know-how developed by them has been allowed to be spread over three years.

6.33 The Budget also effected major changes in the structure of corporate taxation to induce higher generation of internal resources and increase incentives for investment, modernisation, growth and employment. The basic rate of corporate tax was reduced by five percentage points to 50 per cent for widely held companies. Further, in order to benefit companies in employment-oriented sectors, such as services, the distinction between industrial and other closely-held companies (except trading and investment companies) was removed in regard to tax rates. As a result, the tax rate for these companies stood reduced from 65 per cent to 55 per cent. Besides, the provision relating to disallowance of 20 per cent of expenditure on certain items like advertisement, publicity and sales promotion was discontinued; so also was the disallowance provision of 15 per cent of interest paid by non-financial companies on public deposits. The levy of interest tax was discontinued in respect of interest accruing after 31st March, 1985.

6.34 To promote the growth of the tea industry and to help it mobilize internal resources for investment in new machinery, fresh planting and re-planting, enterprises engaged in the manufacture and growing of tea were made eligible to a deduction upto 20 per cent of their profits deposited in a special account with the National Bank for Agriculture and Rural Development (NABARD). Withdrawal from the account would, however, be allowed only for specified purposes approved by the Tea Board.

6.35 To stimulate exports, the existing concession under Section 80 HHC was replaced by a more liberal provision under which exporters are allowed a deduction of an amount upto 50 per cent of their export profits carried to a reserve account to be utilised for purposes of their business.

6.36 In order to simplify and rationalise the income tax structure some of the existing exemptions and concessions were weeded out. These included the deduction available in respect of expenditure incurred by companies on approved programmes of rural development, the education expenses available in certain cases and interest paid on money borrowed to pay taxes. Deductions provided in respect of profits and gains from business of livestock breeding, poultry or dairy farming and the dividends received by Indian companies on shares allotted to them in foreign companies were also discontinued.

6.37 An important element of the 1985-86 Budget was to launch a multi-pronged attack on the problems of tax evasion and black money. The basic thrust of this strategy was to combine a structure of reasonable rates and simplified procedures with improvements in tax administration and enforcement. Aside from reforms in the structure of tax rates described above, it was decided to accept, with a minimum of formalities, returns showing income of not more than Rs. one lakh (except for companies and trusts) and in company cases with returned income of not more than Rs. 25,000 and paid-up capital not exceeding Rs. five lakhs (except for new assessees). To plug loopholes for tax avoidance, association of persons whose shares of individual members are indeterminate or unknown have been made liable to income tax at the maximum marginal rate. Exemption from wealth tax has also been discontinued in respect of business assets of charitable and religious trusts. The option of immunity from penal provisions for those who made disclosures after the seizure of incriminating documents and assets has been withdrawn. To speed up the trial and prosecution of economic offenders the Budget announced the setting up of special courts. Furthermore, to minimize the flow of unaccounted funds to political parties, the Budget proposed legislative measure to permit companies to make contributions to political parties out of their profits.

6.38 To assist the endeavours for alleviating poverty, the Budget proposed ambitious new schemes for crop insurance and social security. Under the Crop Insurance Scheme, insurance cover is to be provided upto 150 per cent of the crop loan and the insurance charges are to be fixed at a low level. The marginal and small farmers will be subsidised in respect of the insurance charges by the Central and State Governments on a matching basis. The scheme became operational in most States during the 1985-86 *kharif* crop. The social security scheme announced in the Budget covers risk of death by accident in respect of earning members of poor families comprising landless labourers, small and marginal farmers, traditional craftsmen and others not covered by any insurance or workmen compensation arrangement. To begin with, the scheme is being introduced in 100 districts in consultation with the States.

6.39 The Budget also announced a number of measures aimed at improving the condition of workers, aside from the increase in the exemption limit for personal income tax and in the tax exemption for retrenchment compensation, already mentioned. Earlier, the bonus payable to employees whose salary or wage exceeded Rs. 750 per month was calculated as if the salary or wage was Rs. 750. The Budget proposed raising this limit to Rs. 1,600 per month, while retaining the eligibility criterion*. Furthermore, the Budget proposed that in the event of liquidation, the legitimate dues of workers would be placed on equal footing with secured creditors. These and other steps have been subsequently implemented by the Government.

*The eligibility criterion has been subsequently liberalised by raising it to a salary or wage of Rs. 2500 per month.

6.40 With regard to indirect taxes, the measures in the 1985-86 Budget were designed to stimulate industrial growth, reduce the cost of investment in priority sectors, encourage the growth of small scale industries, promote exports and import substitution and mobilize additional resources. Customs duties were raised in a few cases. The auxiliary duty on crude petroleum was increased from Rs. 100 to Rs. 300 per tonne and the effective rate of basic import duty was fixed at ten per cent *ad valorem.* To reduce capital costs, customs duties on project imports in general were reduced to 45 per cent, to 25 per cent in the case of power projects, and completely withdrawn for fertilizer projects. Concessional rates of duties were extended in the case of components for the manufacture of specified parts of fuel efficient commercial vehicles and maintenance parts as well as for the manufacture of fuel injection pumps and their parts and warranty spares. Further, to encourage the use and manufacture of computers, customs duty was substantially reduced in respect of a few more components for the manufacture of computers and their peripherals and the duty on certain advanced types of computers, not manufactured in the country, was completely withdrawn.

6.41 In view of the shortage of the domestic raw materials as also to conserve forest resources, import duty on wood pulp and wood chips was completely removed and the concession was made available to all user industries. The duty was also slashed in respect of certain specified forms of wood. In order to boost the export-oriented industries, import duty on specified machines used for leather processing and wattle extract was lowered and completely abolished in respect of raw hides and skins, crust leather and finished cattle leather. Import duty was also reduced in the case of specified machinery items used in leather apparel manufacturing industry. Similarly, concessional rate of duty was extended to certain additional components of gem and jewellery machinery and some tools essential for operating them. Other important items in respect of which the import duties were either abolished or reduced included wind operated electricity generators and battery chargers, raw wool, specified intermediates used in the manufacture of anti-TB and anti-leprosy drugs, medical equipments like CAT-scanners, exhaust gas analysers and smoke meters.

6.42 With a view to mobilising additional resources, excise duties were increased in respect of certain items such as cement, cigarettes, aerated waters and crown corks, vegetable products, certain varieties of printing and writing paper and kraft paper. However, laminated paper and paper board intended for packing of milk was fully exempted. Basic excise duty was also raised in respect of commercial vehicles and three-axled vehicles, but that on turbo-charged motor vehicles was slightly reduced. Excise duty relief was allowed in respect of duty paid on tyres, batteries, etc.

6.43 Four new items viz. marble slabs and tiles, travel goods, specified organic chemicals and pan masala were added to the excise tariff. However, small units producing marble slabs and tiles using power up to ten horse power were exempted from duty and a scheme of compounded levy was introduced for marble slabs manufactured by conventional gang-saw units. The duty differential in favour of mini steel plants in respect of iron and steel products was reduced from Rs. 143 to Rs. 50 per tonne and the duty rates on other steel products were rationalised.

6.44 Several items were exempted from excise duty such as computers, black and white TV sets of 36 cms, zip fasteners, accessories of cycles and shoddy woollen blankets. Similarly, the duties on various agricultural implements and parts, specified poultry equipments, and medium tractors upto 25 power take-off horse power were withdrawn. The duty structure was rationalised in the case of certain commodities such as matches, household laundry and toilet soap and certain electronic items. Duty rates were also changed from *ad valorem* to specific in the case of most gases, tubes and flaps.

6.45 Tariff descriptions of cotton fabrics and woollen fabrics were rationalised on the basis of predominance of fibre. Unprocessed cotton fabrics were completely exempted from duty. Duty differential in favour of power processors of cotton fabrics was removed. Duty on cotton yarn was increased to partially recoup the loss on account of reduction in duty rates on cotton fabrics. Blended yarn of polyester cotton and viscose containing less than 70 per cent polyester was made chargeable to basic duty at Rs. 8.80 per kg.

6.46 To encourage the growth of the small scale units and to help them to graduate to medium scale operations, the eligibility limit for clearances was raised from Rs. 25 lakhs to Rs. 75 lakhs in the case of the General Excise concession scheme and the scheme was further liberalised by providing slab rates of excise duties. A similar scheme with some modifications was also introduced in respect of goods covered under Item 68.

6.47 As a measure of simplification, all items, except 32, were exempted from special excise duty. In some of these cases, the special excise was merged with the basic duty. Following the recommendations of the Eighth Finance Commission, the rates of stamp duty on bills of lading and letters of credit, the yield of which goes to the States, were raised.

6.48 The 1985-86 Budget was also novel in seeking to integrate fiscal changes with industrial and financial policies. The Budget speech announced delicensing of a number of priority industries and proposed raising of the asset threshold for MRTP companies, taking into account the increase in price level since the earlier limit was fixed. The ceilings of investment in plant and machinery defining small-scale units and ancillaries were also increased. To enable companies to mobilize additional resources, the interest payable on non-convertible debentures of non-MRTP and non-FERA companies was raised from 13.5 per cent to 15 per cent. The Budget also proposed amendment of the Securities (Contracts) Regulation Act to ensure free transfer of securities. A new investment instrument of convertible cumulative preference share was introduced. To help raise resources for the public sector the Budget announced a scheme for issue of bonds by public sector undertakings in high priority areas, such as telecommunications and power. The bonds, besides carrying an attractive rate of interest and entitlement to exemption under Section 80L of Income Tax Act, would also be exempt from wealth tax. To facilitate tapping of savings from rural areas no deduction of tax is to be made at source in respect of interest paid on such bonds.

6.49 The additional resource mobilisation measures introduced in the 1985-86 Central and Railway budgets were expected to yield about Rs. 973 crores —Rs. 478 crores through fresh taxation and Rs. 495 crores through revision in the Railway fares and freight rates. Fresh taxation measures were estimated to yield additional resources of this order despite a loss of about Rs. 200 crores on account of concessions given in income tax and a loss of Rs. 170 crores on account of discontinuance of the interest tax. Of the total of Rs. 478 crores of additional taxation in 1985-86, the Centre's share was Rs. 344 crores, and the States', Rs. 134 crores. The details are shown in Table 6.3.

TABLE 6.3

Additional Resource Mobilisation through Central Budget for 1985-86

(Rs. crores)

	Centre's Share	States' Share	Total
I. Taxes[1]	**343.79**	**134.09**	**477.88**
(*a*) *Direct Taxes* . .	(—)119.49	(—)2.51	(—)122.00
(*i*) Corporation tax .	248.00	..	248.00
(*ii*) Income tax . .	(—)197.49	(—)2.51	(—)200.00
(*iii*) Interest tax . .	(—)170.00	..	(—)170.00
(*b*) *Indirect Taxes* . .	463.28	136.60	599.88
(*i*) Customs duties	284.95	..	284.95
(*ii*) Union excise duties .	178.09	136.60	314.69
(*iii*) Stamp duties[2] .	0.24	..	0.24
II. Revision in the Postal and Telecommunication Tariffs and Railway Fares & Freights.	**495.00**	..	**495.00**
(*a*) Railways . .	495.00	..	495.00
(*b*) Posts and Telecommunications . .	..	..	..
III. Total (I+II) . .	**838.79**	**134.09**	**972.88**

[1] After taking into account changes announced during the Budget debate.

[2] Proposals in respect of Stamp duties were expected to yield Rs. 12 crores to States and Rs. 0.24 crore to Centre in relation to Union Territories without legislature. The States' yield of Rs. 12 crores has not been shown in this Table as the amount would accrue direct to the States and not as share in Central Taxes.

6.50 There was no revision in the postal and telecommunication tariffs in the 1985-86 Budget. In the case of Railways, however, the revisions in fares and freight rates were expected to generate an additional revenue of the order of Rs. 495 crores. A surcharge of 12.5 per cent (later reduced to ten per cent) was levied on all classes of passenger fares. However, with a view to giving relief to the common man, no increase was effected in passenger fares for second class mail/express and second class ordinary for distances upto and inclusive of 50 kms. The fares on monthly second class season tickets were also increased by Rs. three to Rs. 12 for different distance slabs ranging from one to 150 kms. Minimum second class fare on Calcutta Circular Railway was raised from 50 paise to Rupee one per ticket. There was a readjustment in the levy of surcharge on two-tier air-conditioned sleeper and the second class Sleeper surcharge was raised from Rs. eight to Rs. ten for the first night. In order to give relief to long-distance passengers, no sleeper surcharge was to be levied for the second and subsequent nights. The age limit for free travel by children which was enhanced from three to five years in 1979 and was continued on an *ad hoc* basis since then, was made regular. Net of certain concessions provided to the youth, the additional annual revenue from passenger traffic was estimated at Rs. 153 crores.

6.51 In respect of freight rates on goods traffic, a supplementary charge of ten per cent on the total freight, in train loads, wagon loads and smalls, was levied. Short-distance traffic upto and inclusive of a distance of 500 kms. was, however, exempted. The minimum distance of charge for goods traffic was increased from 75 kms. to 100 kms. Subsequent to the presentation of the Railway Budget, salt for human consumption was also exempted from the supplementary charge with effect from June 1, 1985. There was a reclassification of goods freight structure and the lowest classes of the goods tariff, namely, classes 65, 70 and 75 were abolished and class 80 made the lowest. The total increase in receipts from goods traffic, net of a concession of 33 per cent in freight rates for sugarcane traffic moving upto a distance of 100 kms., was estimated at Rs. 342 crores.

Revenue and Expenditure

6.52 The budgetary transactions of the Central Government in 1985-86 (BE) envisaged a gap of Rs. 3,660 crores at 1984-85 rates of taxation. Changes in tax rates, announced as part of the Budget proposals, were expected to yield, as the Centre's share, a net revenue of Rs. 344 crores, leaving an uncovered budgetary deficit of Rs. 3,316 crores. This level of deficit was, however, substantially lower than the deficit of Rs. 3,985 crores in the revised estimates of the preceding year.

6.53 Following the recommendations of the Eighth Finance Commission, the States' share in the union excise duties was raised from 40 per cent to 45 per cent. As a result, the growth in the Centre's share in the tax revenue in 1985-86 (BE) was expected to be only ten per cent over 1984-85 (BE), as against a growth of 15.8 per cent in 1984-85 (RE) over the actuals of the preceding year. The growth in non-tax revenues also decelerated from 29.1 per cent in 1984-85 to 21.5 per cent in the current year. However, the increase in capital receipts at 20.5 per cent was higher than the increase of 15 per cent recorded in 1984-85. Thus, the aggregate resources of the Centre in 1985-86 (BE) at Rs. 53,004 crores were higher by 16.7 per cent, a rate which was slightly lower than the growth of 18.2 per cent in 1984-85 (RE).

6.54 In view of the constraint on resources, the total expenditure of the Centre was contained at Rs. 56,320 crores in 1985-86 (BE), which was 19.3 per cent higher than the expenditure budgeted for in 1984-85. While development expenditure was to go up by 17 per cent, the increase in non-development expenditure was 22.9 per cent. For the 1985-86 Central Plan, a provision of Rs. 18,500 crores was made, which was 6.6 per cent higher than the outlay of Rs. 17,351 crores in 1984-85 (BE). While determining sectoral priorities, the emphasis was on completing projects already under implementation rather than taking on new starts, so that the benefits could start flowing early.

Savings and Capital Formation

6.55 Trends in gross savings and capital formation are shown in Table 6.4. Gross savings of the Central Government deteriorated considerably in 1984-85 (RE) and became negative for the first time. This deterioration was accentuated in the current year (BE), when the gross savings were estimated to be as low as Rs. (—)2,284 crores in comparison with Rs. (—)683 crores in the preceding year. Gross capital formation out of budgetary resources of the Central Government, however, showed a steady rise from Rs. 17,872 crores in 1984-85 (RE) to Rs. 19,455 crores in 1985-86 (BE). The gap between gross capital formation and gross savings of the Central Government was financed to the extent of 67.3 per cent and 73.6 per cent through draft on domestic capital receipts and 21.5 per cent and 15.2 per cent through budgetary deficit during these two years, respectively. The draft on foreign savings contributed 11.2 per cent in both these years for financing the gap.

TABLE 6.4

Capital Formation by the Central Government and its financing

(Rs. crores)

	1980-81	1981-82	1982-83	1983-84	1984-85 (R.E.)	1985-86 (B.E.)
I. Gross Capital Formation out of Budgetary Resources of Central Government	**9012**	**10799**	**12403**	**14702**	**17872**	**19455**
	(24.7)	(19.8)	(14.9)	(18.5)	(21.6)	(8.9)
As per cent of Gross Domestic Product at current market prices	7.1	7.3	7.5	7.6	8.4	n.a.
(*i*) Gross capital formation by the Central Government	1907	2552	2884	3356	4149	4472
(*ii*) Financial assistance for capital formation to the rest of the economy	7105	8247	9519	11346	13723	14983
II. Gross Savings of the Central Government	**3**	**1107**	**857**	**313**	**(—)683**	**(—)2284**
As per cent of gross domestic savings at current prices	Neg.	3.3	2.3	0.7	(—)1.4	n.a.
III. Gap (I—II)	**9009**	**9692**	**11546**	**14389**	**18555**	**21739**
Financed by :						
IV. Draft on other sectors of domestic economy	**7339**	**8391**	**9955**	**12778**	**16480**	**19313**
(*i*) Domestic capital receipts	4762	6999	8300	11361	12495	15997
(*ii*) Budgetary deficit	2577	1392	1655	1417	3985	3316
V. Draft on foreign savings	**1670**	**1301**	**1591**	**1611**	**2075**	**2426**

Notes : (*i*) Gross capital formation in this Table includes loan given for capital formation on a gross basis. Consequently, domestic capital receipts includes loan repayments to the Central Government.

(*ii*) Figures in brackets are percentage increases over the preceding year.

Finances of States and Union Territories : 1985-86

6.56 Total expenditure of the States and Union Territories for 1985-86 was budgeted to grow by 18.6 per cent from Rs. 33,701 crores in 1984-85 (BE) to Rs. 39,964 crores in 1985-86 (BE). Their current revenues were estimated at Rs. 30,756 crores; 16.8 per cent higher than Rs. 26,342 crores in 1984-85 (BE). The States' share in Union excise duties in 1985-86 (BE) was estimated to be higher by 20.1 per cent. Grants-in-aid, both Plan and non-Plan, were to increase by 28.9 per cent.

6.57 The gap between current revenues and total expenditure was estimated at Rs. 9,208 crores in 1985-86 (BE), compared with Rs. 7,359 crores in 1984-85 (BE). Bulk of this gap in the current year would be covered by capital receipts (Rs. 8,895 crores), leaving a budgetary deficit of only Rs. 313 crores.

Central and State Governments—Combined

6.58 The combined budget estimates of the Centre, States and Union territories for 1985-86 provided for a total outlay of Rs. 80,326 crores which was 16.6 per cent higher than the outlay in the budget estimates of 1984-85. The growth in their current revenues was estimated at 13.9 per cent, from Rs. 47,593 crores in 1984-85 (BE) to Rs. 54,213 crores. Under tax revenues, Union excise duties and sales tax continued to be the main sources of finance for the Centre and the States respectively, their respective contribution being 31 per cent and 21 per cent in the total tax revenues in 1985-86 (BE). Internal resources of the public undertakings for the plan were expected to register a growth of 17.4 per cent from Rs. 5,755 crores in 1984-85 (BE) to Rs. 6,756 crores in 1985-86 (BE). The gap between total outlay and current revenues was estimated at Rs. 26,113 crores in 1985-86 (BE), of which 86 per cent was to be financed by internal and external capital receipts, while the balance of 14 per cent represented budgetary deficit. These proportions in 1984-85 (RE) were 77 per cent and 23 per cent respectively.

Annual Plan : 1985-86

6.59 The Annual Plan for 1985-86 provided for a total outlay of Rs. 32,239 crores (Table 6.5)—Rs. 19,142 crores for the Central and Union Territory Plans and Rs. 13,097 crores for the State Plans. The aggregate outlay for the first year of the Seventh Plan thus worked out to 17.9 per cent of the targeted outlay for the five year period of the Plan. To finance this outlay, the contribution of the

TABLE 6.5

Annual Plan Outlay : Centre, States and Union Territories

(Amount in Rs. crores)

Heads of Development	Annual Plan 1984-85 Amount	Percentage to total	Annual Plan 1985-86 Amount	Percentage to total
1. Agriculture .	1564.3	5.2	1997.5	6.2
2. Rural development . .	1808.2	6.0	1656.6	5.1
3. Special area programme .	424.5	1.4	540.4	1.7
4. Irrigation and flood control	2681.5	8.9	2781.4	8.6
5. Energy .	9545.0	31.4	10186.9	31.6
6. Industry and minerals .	4595.6	15.2	4663.2	14.5
7. Transport .	3454.7	11.5	3816.7	11.8
8. Communications, information and broadcasting	980.4	3.2	1087.6	3.4
9. Science and technology .	346.5	1.1	444.8	1.4
10. Social services	4334.6	14.4	4786.6	14.8
11. *Others* :				
(*a*) Special incentives scheme for better performance by the States .	200.0	0.7	..	..
(*b*) Others .	234.1	0.8	276.9	0.9
TOTAL . .	30169.4	100.0	32238.6	100.0

balance from current revenue, at 1984-85 rates of taxation, was only a small amount of Rs. 522 crores and that of public enterprises, at 1984-85 tariffs and prices, Rs. 5,069 crores. Additional resource mobilisation envisaged for the year was Rs. 3,203 crores, and inflow of net capital from abroad (including external commercial borrowing) Rs. 3,375 crores. The balance of Rs. 20,070 crores, which was 62 per cent of the total outlay, was to be financed out of domestic borrowings (including Rs. 3,316 crores of deficit financing).

6.60 The energy sector continued to occupy the prime position in the distribution of Plan outlay and its share amounted to as much as 31.6 per cent of the total provision. Relative to 1984-85, increased allocations were made for several sectors, such as agriculture, transport, communications, science and technology and social services.

Post-Budget Developments

6.61 Supplementary demands for grants have been obtained so far twice in the current year, in July and November 1985, involving a net addidtional outgo of Rs. 4,268 crores, of which Rs. 1,628 crores related to medium-term loans given to the States to clear their past overdrafts with the Reserve Bank of India. Of the remaining fresh expenditure of Rs. 2,640 crores, food and fertilizer subsidies accounted for Rs. 800 crores, advance Plan assistance to States for relief on account of natural calamities Rs. 250 crores and another Rs. 45 crores for relief expenditure on non-Plan account. Additional transfers were made to the States under the National Rural Employment Programme (Rs. 107 crores) and Rural Landless Employment Guarantee Programme (Rs. 206 crores). Releases to public sector enterprises involved an outgo of Rs. 717 crores (Rs. 597 crores on Plan account and Rs. 120 crores on non-Plan account). On the Plan side, the bulk of the releases were in respect of investments in Rashtriya Ispat Nigam Limited (Rs. 300 crores) and National Aluminium Company Limited (Rs. 290 crores). On the non-Plan side, loans to National Jute Manufacturing Corporation to meet its cash losses (Rs. 45 crores) and to Delhi Transport Corporation to meet its additional requirements for enhanced dearness allowance and increase in cost of inputs (Rs. 40 crores) accounted for the major portion of the additional releases. Thus, the total net supplementary outgo on Plan account was Rs. 1,462 crores and on non-Plan account (excluding loans to the States for clearance of overdrafts) Rs. 1,178 crores.

6.62 Although there has been a substantial step up in expenditure, a redeeming feature of the budgetary situation in the current financial year has been a remarkable buoyancy in the tax revenue (Table 6.6).

TABLE 6.6

Collections from Major Taxes

(Rs. crores)

	April 1984—January 1985	April 1985—January 1986	Percentage Increase	Percentage of Col(2) to actual collections of 1984-85	Percentage of Col (3) to 1985-86 (BE)
(1)	(2)	(3)	(4)	(5)	(6)
1. Income tax including Corporation tax. .	2928	3627	23.9	65.1	75.3
2. Excise duties .	8994	10454	16.2	81.4	85.5
3. Customs duties	5660	7501	32.5	80.9	91.9
TOTAL . .	17582	21582	22.8	78.0	85.6

6.63 According to provisional figures, the tax collections during the period April, 1985 to January, 1986 has been higher by nearly 23 per cent over the corresponding period of the previous year. This compares with an anticipated increase of around

12 per cent in the budget estimates of 1985-86 over the actuals of 1984-85. The ratio of tax collections, at 86 per cent of Budget Estimates during this period, has also been significantly higher than in the corresponding period last year. Expectations are that the total tax revenue for 1985-86 will be substantially higher than the budget estimates and this, along with the cut in non-Plan expenditure, will help contain the budgetary deficit, despite the supplementary demands noted above.

6.64 The buoyancy in tax revenues appears to confirm the soundness of the two-pronged strategy consisting of reform of the tax structure and the measures adopted to curb tax evasion. In order to improve tax compliance and to induce the tax payers to disclose their true income, the Income-tax Department has issued circulars to the effect that the Department's approach towards those assessees who come forward to declare their true income/wealth voluntarily would be sympathetic and liberal in matters of penalty and prosecution. However, the provisions of penalty and prosecution will be applied stringently in the case of those assessees who do not come forward by March 31, 1986 *suo moto* and are brought in the tax net by the efforts of the Department. Declaration of higher income in the current year will not be taken as a ground for reopening earlier years' assessments or enhancing the assessments of future years.

6.65 Further, to curb tax evasion, smuggling and foreign exchange malpractices, several measures have been taken to strengthen the revenue administration and intelligence machinery. A Central Economic Intelligence Bureau has been recently established to detect major economic offenders and to plan and coordinate operations of various intelligence and enforcement agencies. A series of operations have also been carried out against suspected economic offenders. As a result of the various measures taken, there has been a substantial increase in the seizure of contraband goods. The value of such goods seized during April-Decemer, 1985 has been about double the amount of Rs. 73 crores in the corresponding period last year.

6.66 In line with the Long Term Fiscal Policy, a few legislative measures have been taken recently to simplify and rationalise the excise and customs tariffs. Following the recommendations of the Technical Study Group on Central Excise, a new Central Excise Tariff Act has been legislated which broadly adopts a new classification based on the International Convention on the Harmonized Commodity Description and Coding System (Harmonized System). The tariff has thus been made more comprehensive and the residuary Item 68 has been abolished. By and large, the existing duty structure has been preserved, to the extent possible. This will help in reducing disputes on account of tariff classification and will facilitate charging of additional customs duty on imports equivalent to excise duty. Consequential changes have also been made in the First Schedule to the Additional Duties of Excise (Goods of Special Importance) Act, 1957 and in the Additional Duties of Excise (Textiles and Textile Articles) Act, 1978. Similarly, a new system of nomenclature based on the Harmonized System has been adopted for the Customs Tariff which will greatly facilitate international trade as well as tariff negotiations. The rates of duty have been transposed in the new schedule, maintaining the existing level as far as possible. The Customs Act, 1962 has also been amended with a view to remove certain practical difficulties experienced in its administration.

6.67 During the post-Budget period certain further adjustments in excise and customs duties have been made. In the wake of the announcement of the new Textile Policy and to encourage the production of cheaper blended fabrics, excise duties on man-made fibres/yarn and fabrics were lowered. Excise duty on polyester fibre was reduced from Rs. 45 to Rs. 25 per Kg. Excise duty as well as countervailing duty of customs in the case of supplies of polyester fibres for production of low priced fabrics were withdrawn and that on acrylic fibre reduced from Rs. 17.50 to Rs. ten per kg. Duty on polyester-cotton yarn containing more than 40 per cent but less than 70 per cent by way of polyester fibre was reduced from Rs. five to Rs. two per kg. On similar blends of polyester viscose yarn duty was reduced from Rs. ten to Rs. four per kg. Duty on polyester viscose blended fabrics has also been reduced to 5 per cent *ad valorem* from the earlier level of 13.2 per cent. The excise duty structure for cigarettes was rationalized by reducing the number of slabs and by providing different rates for such slabs. The excise duty rates on aluminium and products thereof were reduced by about six percentage points in the context of the upward revision in the controlled prices of aluminium so as to keep the sale price to consumers by and large at the existing levels. Certain electronic components like valves and tubes, transistors and semi-conductor diodes were exempted from duty. On the other hand exemption was withdrawn in the case of footwear and parts thereof, from duty paid resins or plastic material. Basic excise duty on specified parts of refrigerating and air-conditioning appliances and machinery was increased from 80 per cent to 110 per cent.

6.68 Customs duty on certain additional specified gem and jewellery machinery items and leather industry machines, raw materials and components has been reduced to promote their development. Import duty has also been reduced in the case of computers as well as specified electronic items. In view of the comfortable domestic availability of cotton and to promote its consumption, the basic customs duty on viscose staple fibre and viscose tow as well as on their high performance varieties has been increased to 55 per cent.

6.69 Having regard to the trend in international prices, export duties in respect of coffee, black pepper as well as semi-finished leather were adjusted.

Economy Measures

6.70 Against the background of a constrained resources situation and with a view to containing the budgetary deficit during 1985-86, the Central Government took several measures to cut expenditures. A working group under the chairmanship of the Cabinet Secretary was set up to review all on-going activities and organisations and to discontinue those which had lost their utility. All Ministries and Departments were asked to effect a minimum five per cent reduction in their non-Plan expenditures. Orders were issued banning creation of new posts or filling up of vacancies except in exceptional circumstances. It was expected that these measures would result in a reduction of about Rs. 800 crores in non-Plan expenditure during the current year.

6.71 The Government has recognised, in principle, the need for Central Government departments to adopt zero-base budgeting. This would require identification and sharpening of objectives, examination of various alternatives of performing identified tasks, cost-benefit analysis, prioritisation of objectives and activities, identification and elimination of redundant activities and designing and ranking of decision packages. It is proposed to commence zero-base budgeting in various departments in stages.

States' Overdrafts

6.72 Despite the Overdraft Regulation Scheme introduced in 1972-73 and modified in October, 1978, there had been widespread recourse to overdrafts by a number of States. In addition to the increased limits on ways and means advances from the Reserve Bank, the Government of India had to provide *ad hoc* assistance, on a number of occasions, to State Governments to clear their overdrafts with the Reserve Bank. With a view to imparting financial discipline the Centre advised the States on February 4, 1985 to restrict their unauthorised overdrafts in the financial year 1984-85 to the level of Rs. 1,809 crores reached on January 28, 1985. Government of India have now converted 90 per cent of this amount (Rs. 1,628 crores) into medium-term loans. These loans are recoverable in four equal instalments during the Seventh Plan period itself. Necessary provision has been made in the assessment of the States' resources, and, therefore, the size of their Seventh Plan will remain unaffected. The States have been informed that they should not run overdrafts with the RBI for more than seven continuous working days from October 1, 1985. This is being strictly enforced and no overdraft was outstanding against any State on January 31, 1986.

Central Government Departmental Enterprises

Railways

6.73 The financial position of the Railways came under severe stress in 1984-85 on account of a variety of reasons. The original target of 245 million tonnes of revenue earning traffic in 1984-85 had to be scaled down to 237 million tonnes, because of shortfalls in traffic offering from the core sector, frequent strikes in some of the collieries, more than normal breaches and interruption in communications, particularly in the north-eastern and southern India and disturbed civil conditions in some areas. As a result, gross traffic receipts of the Railways went down by Rs. 67 crores, from Rs. 5,457 crores in 1984-85 (BE) to Rs. 5,390 crores in 1984-85 (RE). Net ordinary working expenses, on the other hand showed an increase of Rs. 144 crores, from Rs. 4,011 crores to Rs. 4,155 crores, mainly on account of additional expenditure on dearness allowance, increases in prices of fuel, flood damage etc. Net Railway revenue, therefore, came down to Rs. 209 crores in 1984-85 (RE), compared with Rs. 420 crores estimated at the Budget stage. After taking into account their dividend liability, the Railways were estimated to have incurred a loss of Rs. 266 crores in 1984-85 (RE) which was treated as their deferred dividend liability to the General Revenues.

6.74 In 1985-86, the Railways expect to carry 250 million tonnes of revenue earning traffic, *i.e.* 5.5 per cent more than in 1984-85. Growth in passenger traffic was assumed at two per cent in non-suburban and four per cent in suburban passenger traffic. Gross traffic receipts, inclusive of additional resource mobilisation of Rs. 495 crores, were estimated at Rs. 6,151 crores in 1985-86 (BE) and the total working expenses Rs. 5615 crores. Taking into account the net miscellaneous receipt of Rs. 50 crores, the net revenue worked out to Rs. 586 crores. After providing for full dividend to General Revenues, the Railways were to be left with a surplus of Rs. 74 crores.

6.75 In December, 1985 the Railways presented a supplementary demand for grants, involving a net outgo of Rs. 400 crores, which was primarily intended to expedite the progress of their ongoing works/schemes under the Plan, particularly rolling stock, line capacity works, track renewals, electrification projects, signalling and telecommunication and workshops. Thus, the Annual Plan outlay of the Railways for 1985-86, which was fixed at Rs. 1,650 crores, stood augmented at Rs. 2,050 crores.

Posts and Telecommunications

6.76 The financial working of the erstwhile Posts and Telegraphs Department deteriorated in 1984-85 (RE). While gross receipts declined by Rs. 90 crores from Rs. 1,750 crores in the budget estimates to Rs. 1,660 crores, the decline in net working expenses was only Rs. 36 crores. Further, their dividend liability to General Revenue increased by about Rs. 12 crores. The combined result of all these factors was that the surplus which was put at Rs. 187 crores in 1984-85 (BE), came down to Rs. 122 crores in that year's revised estimates.

6.77 The erstwhile combined Posts and Telegraphs Department was bifurcated into Department of Posts and Department of Telecommunications. The budget estimates for 1985-86 envisage that while the operations of the Department of Posts would result in a loss of about Rs. 202 crores, significantly larger than the loss of Rs. 142 crores in the preceding year, the Department of Telecommunications would increase its surplus from Rs. 264 crores in 1984-85 (RE) to Rs. 308 crores in the current year.

Performance of Central Government Public Enterprises

6.78 The performance of public sector enterprises of the Centre, as a group, was the best in 1984-85 in terms of net profits, which crossed the previous peak of 1982-83 and exceeded by a wide margin the net profits realised in 1983-84 (Table 6.7). The net profits of 205 enterprises aggregated to Rs. 929 crores in 1984-85 compared with Rs. 240 crores by 201 enterprises in 1983-84 and Rs. 614 crores by 193 enterprises in 1982-83. A noteworthy feature of the performance in 1984-85 was that there was an increase in the net profits (before tax) of the profit-making enterprises (from Rs. 3,016 crores in 1983-84 to Rs. 3,213 crores in 1984-85), as well as a reduction in the losses of the loss-making enterprises (from Rs. 1,536 crores to Rs. 1,094 crores). While the profits before tax of petroleum group of enterprises showed a marginal improvement from Rs. 2,017 crores to Rs. 2,027 crores, the profits in the case of other profit-making enterprises increased by 18.7 per cent, from Rs. 999 crores in 1983-84 to Rs. 1,186 crores in 1984-85.

6.79 Almost all important financial indicators showed a distinct improvement in 1984-85. Total sales during 1984-85 registered an increase of 15.6 per cent. While the total capital employed increased in 1984-85 by 21.9 per cent, gross profits as a proportion of the capital employed also went up from 11.9 per cent in 1983-84 to 12.7 per cent. The profit-making and the loss-making enterprises (except those incurring cash losses) generated gross internal resources of the order of Rs. 4,880 crores which was a significant improvement over the corresponding figure of Rs. 3,695 crores in 1983-84.

6.80 The improvement in the financial performance in 1984-85 was mainly because of the three infrastructure sectors of steel, chemicals and fertilisers, and petroleum. In the case of steel, the overall loss had declined from Rs. 244 crores in 1983-84 to Rs. 82 crores. Chemicals and fertilisers had also

TABLE 6.7

Profile of Public Enterprises (1980-81 *to* 1984-85)

	Unit	1980-81	1981-82	1982-83	1983-84	1984-85 (Provisional)
1	2	3	4	5	6	7
1. Number of running public enterprises	Number	168	188	193	201	205
2. Capital employed	Rs. crores	18207	21935	26526	29851	36390
3. Turnover	Rs. crores	28635	36482	41989	47272	54668
4. Gross margin (profit before depreciation, interest, and tax)	Rs. crores	2401	4012	5184	5770	7398
5. Depreciation*	Rs. crores	983	1358	1719	2205	2761
6. Gross profit before interest and tax	Rs. crores	1418	2654	3465	3565	4637
7. Interest	Rs. crores	1399	1630	1923	2085	2518
8. Net profit before tax	Rs. crores	19	1024	1542	1480	2119
9. Tax	Rs. crores	222	578	928	1239	1190
10. Net profit after tax	Rs. crores	(—)203	446	614	240	929
11. Internal resources generated	Rs. crores	1225	2261	2753	3695	4880
12. Gross profit to capital employed	per cent	7.8	12.1	13.1	11.9	12.7

*Includes deferred revenue expenditure.

earned a marginal profit (Rs. 15 crores) after having incurred a loss of Rs. 66 crores in the preceding year. In the petroleum sector, on the other hand, the profits has gone up from Rs. 1,013 crores to Rs. 1,117 crores.

6.81 The outlook for 1985-86 also appears promising. Provisional data are available for 100 enterprises for the first nine months of the current year; these indicate that the net profit of these enterprises has increased to Rs. 550 crores from Rs. 383 crores in the corresponding period of 1984-85.

State Governments' Commercial Undertakings

6.82 Forests and mines and minerals continued to be the two major profit-making departmentally-run undertakings of the States and Union Territories. Net contribution of forests amounted to Rs. 455 crores in 1984-85 (RE) and was estimated at Rs. 494 crores in 1985-86 (BE). In respect of mines and minerals, the net contribution worked out to Rs. 36 crores and Rs. 39 crores respectively in these two years. Dividend receipts from departmentally-run undertakings, however, stagnated at about Rs. 38 crores.

6.83 Of the loss-making departmentally-run undertakings, irrigation (commercial) incurred a loss of Rs. 592 crores in 1984-85 (RE) and of Rs. 651 crores in 1985-86 (BE). Losses of multipurpose river valley schemes were estimated to go up in 1985-86 (BE) to Rs. 115 crores compared with the loss of Rs. 106 crores in 1984-85 (RE). In respect of dairy development and industries, losses were estimated at Rs. 19 crores in 1984-85 (RE) and Rs. 41 crores in 1985-86 (BE). Departmentally-run power projects and road and water transport services, however, were likely to reduce their losses to Rs. 51 crores in 1985-86 (BE) from Rs. 119 crores in 1984-85 (RE).

6.84 The performance of the State electricity boards (SEBs) continued to deteriorate and their commercial losses increased to Rs. 1,123 crores in 1984-85, compared with Rs. 948 crores in 1983-84. It is estimated that during the Sixth Plan period as a whole, the commercial losses of the SEBs at current prices, were about Rs. 4,400 crores, that is, almost the same as envisaged in the original Plan estimates (at 1979-80 prices). This, in other words, implies that their entire additional resource mobilisation effort of more than Rs. 5,200 crores, during the Sixth Plan period, was just enough to take care of the cost increases. In 1985-86, their losses are projected to go up still further to Rs. 1,373 crores. Since these increases in losses are expected despite the upward revisions in electricity tariffs undertaken by the State electricity boards from time to time, it is a matter of deep concern. In the case of the State road transport corporations too, the entire yield from revisions in tariffs in the Sixth Plan had been just enough to cover the escalation in costs, and they continued to incur commercial losses ranging from Rs. 150 crores to about Rs. 200 crores in each year of the Sixth Plan. For 1985-86, it appears, the situation will be no better.

Conclusions

6.85 The principal task of fiscal policy will be to mobilise resources sufficient for financing the Seventh Plan and to do so in a manner which promotes equity and is conducive to overall economic growth. As the Long Term Fiscal Policy has emphasised, fiscal policy will have to accord priority to improving budgetary savings and increasing the surpluses of public sector undertakings and thus bring about relatively lower reliance on borrowed funds. For the budget, this will require careful control of non-Plan revenue expenditures and perseverance with the present multi-pronged fiscal strategy to raise revenues. Recent measures taken to contain the growth of subsidies will help to free more resources for the Plan. Further steps are necessary to ensure better programming of expenditure in the medium-term and to effect improvements in administrative efficiency and reduction in costs. It will also be necessary to ensure that the States observe the requisite fiscal discipline.

6.86 Non-inflationary funding of the Seventh Plan requires fulfilment of the targeted improvement in surplus generation by the public sector enterprises. These undertakings represent enormous social investments, undertaken over decades at great cost. It is imperative that these enterprises generate sufficient returns to finance future expansions. Apart from the adoption of rational and economic pricing policies, what is even more important is the need to raise their operational efficiency. This calls for a multi-faceted strategy to improve organisation and procedures, to cut costs and increase production and to bring about better coordination among key infrastructure producing units.

6.87 Whether in Government or in public sector undertakings, wasteful and unproductive expenditures can only undercut the fundamental objectives of the Seventh Plan. In a poor society, where raising resources is difficult and the needs for public expenditure large, it is imperative that the returns to investments are maximized.