

## Fiscal Policy Must Focus On Inflation

The trade-off emerging from the suggestions of the Task Force (Vijay Kelkar) regarding the withdrawal of tax concessions granted to companies for purposes of export promotion, infrastructure, and backward areas development in exchange for withdrawal of tax on dividends and long-term capital gains tax on equities can adversely affect the economic growth. The structural development occurring through the improvements in backward areas, infrastructure facilities and exports can increase the employment and growth generating capacity of the economy which have a greater economic priority than that of the equities market as the latter's role arises at a subsequent stage for fine tuning allocation and valuation of resources.

Moreover, granting exemption from long-term capital gains tax to only one financial instrument like equity is not only discriminatory and distortionary, but also highly inequitable. In contrast, the existing long-term capital gains tax scheme has been quite successful in promoting long-term investments in various assets and in addition, has mobilised substantial resources for infrastructure and agricultural projects. Hence, the existing long-term capital gain tax scheme need to be retained as it is.

In the sphere of customs and central excise/Cenvat, the TF has made many proposals of which some require reconsideration from the view points of revenue, cascading inflationary impact of essential goods in short supply and specific industry growth.

In the central excise/Cenvat, the composite cotton textile units manufacturing yarns, fabrics and garments are proposed to be taxed at the rate of 14 per cent, but considering the current plight of the industry, the needs for its modernisation and at the same time, its potential to generate additional employment and exports, the maximum Cenvat/central excise on such units should not be fixed at a level more than 8 percent.

The proposal of the TF to reduce excise duty on cars should also be reviewed as the owners of cars, two-wheelers and tractor owners enjoy the benefits of road and infrastructure construction programmes. They should bear the extra tax and cess for the same (as was done in California in 1999). Hence, the excise duty on them should not be reduced even from revenue consideration.

In respect of customs duties, the TF has proposed 20 per cent rate for finished goods and 10 per cent on raw materials and intermediates. As both the rates together will provide cost raising high protection to domestic manufacturers at the cost of consumers, the customs duty on both raw materials and intermediates should...

beat lower level of 5 percent. The same rates should be applied for customs duties on imports of edible oil seeds and unrefined edible oils as there is perennial shortage of these commodities in the economy.

The TF has further suggested import duty of 8 per cent for crude oil and of 15 per cent for petro-products, resulting undue protection for manufacturers of petro-products. Hence, import duty on petro-products should also be

placed at 8 percent, as their prices play an important role in costs and prices in the economy.

The other important fiscal problem in the Budget reflects the policy of the government to stockpile a huge quantity of food grains with FCI at prices higher than those recommended by the expert committee. The cost involved in storing these food grains is also huge: estimated at around Rs 2,200 per tonne per annum, but surprisingly only a small part of the food subsidy would have reached the people below the poverty line.

With a view to reducing this fiscal burden and achieving the objective of the helping those under the poverty line only, the obvious and short-term steps would be to scale down the stocks of food grains to the level of around 25 per cent million tonne (as it used to be in the earlier years) through lower procurements from the next year onwards, and evolve alternative marketing systems. Secondly, the composition of stock should undergo a change so as to meet the consumption habits of the below the poverty line which include coarse grains, instead of wheat and rice only.

The other policy steps for promoting new investments in agriculture and improving productivity therein will require the withdrawal of restrictions on trade in all agricultural commodities within the country and decanalisation of their foreign trade. Furthermore, the encouragement to co-operatives and corporate farming can channelise fresh investments from other sectors towards agriculture.

Even after dismantling of the administered price mechanism in the petroleum sector from April 2002, contrary to the expectations, it continues to adversely affect the fiscal balance.

The success of this reform albeit depended not only on the decontrol of price mechanism for crude oil, naphtha, LSHS, LPG, CNG, petrol, kerosene and diesel, but also on the removal of all types of controls and monopolies on their imports, distribution and sales and abolition of the assured return (post-tax 12 percent) schemes.

In contrast, state-run oil companies have formed...

a cartel which has raised the prices of petro-products and is earning higher profits at the cost of consumers. Besides, the government has prescribed a license-permit raj like uneconomic and prohibitive condition of investment of Rs 2,000 crore for the development of the oil industry for those who want to join distribution business.

This would obviously raise the cost of distribution and price of oil products.

Moreover, in the context of relatively higher domestic prices of crude oil products than their international prices, the present level of assured returns themselves are obviously contributing to the higher level of prices of oil products and causing requirement of more subsidies thereon and increasing burden on the Budget. Such returns in practice contain substantial subsidy to these cartel companies, particularly when other companies are not earning such returns in the present state of the economy. Hence, assured returns schemes need to be scrapped and the companies be allowed to earn their margins competitively.

The oil prices exercise cascading effect on energy and transport sector and thereby generate cost-push effect on inflation. The fiscal policy must now seriously think about the inflation, fiscal balance and rising liquidity in the economy, as the rate of inflation measured by whole sale price index has increased from 1.50 per cent in January 2002 to 4.42 per cent in January 2003 which is quite a sharp rise; it would be important to recall that in 1996, the annual rate of inflation crossed 6 per cent, causing difficulties for the majority of the citizens, and thereafter there was a change in political power at the Centre.

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