CHAPTER II

INTRODUCTION

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In common usage 'Industry' refers to manufacturing sector which may include building, mining and public utilities. Industrialisation, in this sense, means establishment and development of manufacturing industries. The process of industrialisation, however is not confined to the establishment of a manufacturing industry but involves a change in the whole economic structure of the country concerned. The process of industrialisation involves apart from the building of new industry those basic changes that acompany, the mechanisation of an enterprise, the opening of a new market and the exploitation of a new territory. This is in a way a process of 'deepening' as well as 'widening' of capital.

In a wide sense the term 'industry' is quite flexible and includes all those activities whereby :

1. desirable goods are extracted from the earth.
2. they are manufactured into finished goods and given more useful form,
3. are taken away from one place to another,

4. kept in warehouses in order to provide them time utility and then ultimately,

5. they are placed in the hands of those who pay for them.

To be more precise, industrialisation implies :

a) the use of power, machinery, modern technique and organisation,

b) capital investment on a large scale,

c) division of labour and exchange and distribution of goods with the help of deveeloped monetary system.

d) the transformation of the whole economy,

e) production of implements for agriculture to facilitate intensive agriculture, manufacture of fertilizers etc.

In this sense, industrialisation is conceived as part of the much broader process of economic development and especially activities involved in the building and operation of a modern economic infrastructure, i.e. an absolute and relative growth in the importance of factories, mills, mines, power plants, and public utilities.

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The industrialisation means the establishment of new industries or building new means of production. During the process of industrialisation all of what we commonly call the 'basic' industries appear as new industry, and their establish-ment absorbs new accumulated capital.

NECESSITY OF INDUSTRIALISATION

In this era of planned development industrialisation is a leading sector in economic growth. It is held to be crucial to development strategy because it radiates stimuli throughout the economy and lifts it out of stagnation. Industrial expansion once started touches off a progressive spiral which leads the economy, from the take off to self-sustained growth industria-lisation can bring forth both backward linkage effects and forward linkage effect. An industry will have backward linkage effect when every non-primary economic activity will induce attempts to supply through domestic production the inputs needed in that activity similarly, and industry will have forward linkage effects when every activity that does not by its nature cater exclusively to find demand will induce attempts to utilise this output as inputs in some new activity. The success of Western countries in this field followed by Japan is a standing example of what industrialisation can do to a nation.

In fact, economic development is synonymous with industrialisation, as it comprises development of industry, trade, transport, power, agriculture and mining etc. and as already stated, industry is the leading sector in development. In a way real progress of an economy depends on industrialisa--tion.

Without industrialisation full utilisation of resources of a country is not possible. In spite of rich resources, a country like India remains backward because industrialisation has not taken place to the desired extent. It is through industrial development that all agricultural, mineral, forest and human resources can be put to the maximum use leading to full employment and an immense increase in income. It is on account of this that all industrialised countries are developed, rich and strong.

Industrialisation leads to higher national and per capita income since by utilisation of resources, increased employment and greater production national prosperity increases. The per capita average income of 18 industrialised countries was 6980 U.S. dollars (1977) while that of agricultural countries was only 170 U.S.dollars.

Industrialisation leads to capital formation as a vital catalyst of economic prosperity. Industry brings in good profit and greater income leading to greater savings which can create more investments. Industrialisation diverts resources to increase the stock of capital goods with a view to boosting production in the future.

Without industrial progress a country cannot produce goods and services needed to attain decent living standard for its citizens. Hence industrialisation has been regarded as an important instruments for eradication of poverty. As industrial development takes place, the demand for energy increases leading to greater generation of electricity which is helpful to agriculture, transport, trade etc. also.

Industrialisation involves 'the organisation of production in business enterprises, characterised by specialisation and division of labour. It leads to application of modern technology'. Industrialisation is of critical importance for the defence of a country.

The modern industry can directly or indirectly raise the productivity of labour force and increase national output. Industries employ more persons and thereby reduce the population burden on land.

These advantages induce developing countries to adopt the process of industrialisation.

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INDUSTRIALISATION AND INDIA

India is a developing country. The outstanding characteristics of Indian economy are as under : -

1. Low national income.

2. Lack of adequate capital.

3. Low level of productivity.

4. Pressure of population on natural resources.

5. Too much dependence on agriculture.

6. Dependence on export of raw material.

7. Inequality of income and wealth distribution.

8. Unemployment and underemployment.

9. Regional imbalance.

The Government of India has adopted a sound industrial policy. The Government has recognised that industry is the key to economic development of a country. No country can progress and prosper without its industrial development and balanced industrial growth is possible without an industrial policy.

The national Government announced its first Industrial Policy on 6th April, 1948. The chief object of this policy were to bring justice and equality of opportunity, increasing the standard of living of people, increasing the production both in agricultural and industrial sector, the offering of opportunities to all for employment etc. The industrial policy gave importance to basic industries namely coal, iron and steel, air crafts manufacture, ship buildings, manufacture of telephone, telegraph and wireless sets and mineral oils. The important role of cottage and small scale industries in the national enconomy was recognised.

The second Industrial Policy Resolution 1956 also gave importance to the development of heavy industries and machine making industries. The industrial policy has given due weightage to public sector. Industrial policy statement 1980 also recognised the importance of industrial development and rèsearch and modernization.

A change in the Industrial Licensing Policy was announced in February, 1970 by the Government of India in the light of the recommendations of the Administrative Reforms Committee (ARC) in Industrial Licensing Policy Enquiry Committee (Dutt Committee) and the Planning Commission. This policy aims at giving much greater freedom to private enterprise.

The objective of eliminating excessive concentration of economic power is sought to be achieved both by modification in the licensing policy with regard to large industrial houses and through the enactment of the Monopolies and Restrictive Trade Practices Act (MRTPA), which came into operation with effect from 1st June,1970. Clearance under the MRTPA is necessary before industrial licence can be granted to such firms as are already within the ambit of the Act. Apart from the general consideration, the new industrial licencing policy is oriented towards providing greater opportunities to fresh enterprenuers in the industrial field and the small entre--prenuers. The new policy also envisages that there will be a joint sector of enterprises, comprising both public and private entreprenuers. The Government had announced certain changes in the Industrial Licencing Policy on the 2nd February, 1973. The main object of amending the policy was that greater clarity in the investment climate would facilitate the priorities and production objectives of the Fifth Plan. In the 1973 Industrial Policy " joint sector " has been accepted as a device which may be resorted to in specific cases with regard to the fulfilment of the production targets of the Plan. In March 1977, the Congress Party was defeated at the polls and the Janata Party assumed power at the Centre. Immediately, it wanted to introduce a new industrial policy.

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In December,1977, the Janata Government announced its New Industrial Policy, known as ' Industrial Policy Statement 1977'. The broad objectives of the 1977 Industrial Policy are as follows -

1. Doubling the rate of growth of national income from 3.5 to 7 per cent per annum.

2. A rapid increase in the rate of growth of industrial production,

3. Creating larger employment opportunities and

4. Reducing wide regional disparities and imbalances.

The Congress (I) Government announced its industrial policy in July 23, 1980. The new industrial policy which included major relaxations and concessions benifitting the small, medium as well as large-scale sector with the triple object of modernisation, expansion and spread to backward areas.

The following socio-economic objectives were laid down by the industrial policy 1980.

1. Optimum utilisation of the installed capacity.

2. maximising production and achieving higher productivity, higher employment generation.

3. correction of regional imbalance through a preferential development of industrially backward areas.

4. faster promotion of export-orinted and import substitution industries etc.

The Union Government announced on 16th March, 1985 its decision to delicense 25 industries (Annexure 4) under the Industries (Development and Regulation) Act. This has been done in pursuance of the budget proposals for 1985-86. This facility will be available to only those companies which do not fall within the purview of the MRTP Act and also the FERA. The other two conditions, which have to be ascertained before qualifying for de-license, include that the article of manufacture is not reserved for small scale sector and that an industrial undertaking is not located or proposed to be located (i) within the standard urban limits (as determined in the Census of India 1981) of a city having a population of more than 10 lakhs and (ii) within the minimum limits of a city with a population of more than 5 lakhs as determined in the said census.

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SOCIAL ROLE OF TAXATION IN INDIA

Generally major objective of taxation is to raise revenue for meeting Government expenditure. But besides their revenue producing qualities taxes are now being taken as potent tools for achieving some important social and economic goals. Now it is being increasingly recognised that the highest function of taxes is to accomplish positive socio-economic objectives rather than just to raise the revenue.

One of the major goals of taxation is to achieve a reasonable degree of price stability. If any Government purchases any substantial amount of goods and services without taxing aggregates spending by the public and private sectors, it will quickly generate a strong excess demand resulting in an inflationary bias in the country. Therefore, to have a reasonable degree of price stability a reasonable tax base is a potent tool in the hands of Government. Similarly to stimulate private demand, Government may reduce the income-tax on individuals or corporations. Becasse of its ability to achieve desired effects on particular occasions, income tax as a part of fiscal policy is gradually being accepted as a very powerful instrument to achieve the goals of economic growth with full employment and reasonably stable price level. It is pointed out that Income-tax collections and effective rates tend to very directly with the economic cycle, the progressive rate proponents observe that this factor combined with a relatively constant level of Government expenditure provides an automatic stimulus in the recession phase of the cycle and a deterrent against inflation in the recovery hase.

There are certain accepted canons of taxation like equality, stability, certainty, and capacity to pay alongwith some socio- economic objectives. Various exemptions and reliefs and a large number of weighted deductions have almost developed into a systematic network giving a boost to savings, encouraging investment in productive channels and providing for some reliefs to needly and physically handicapped. It is widely accepted that the single important factor for bringing people to invest in L. I. C. policies and other savings schemes is rebate of Income Tax.

Exemption provided for investment in backward areas acts as a catalyst for attracting entrepreneurs to invest in hitherto untapped and economically backward regions. This helps, though in a limited measure, to diversify industries evenly and helps boost some industrial activity in backward places.

Incentives provided like export development allowance etc. have helped exporters to harness new markets and undertake survey abroad resulting in better exports and more employment opportunities.

Another objective of tax policies is reduction of concentration of wealth in a few hands and equitable distribution of national wealth. It is true that in practice taxes by themselves have not been able to solve the problem of economic imbalance and there are numerous practical difficulties but income tax does act ~~not~~ as a positive disincentive to earn unlimited amounts at the expenses of others. This acts as a check for people who have an insatible hunger for large fortunes. Wealth Tax and estate duty have a positive role to play in restricting the unbridlled growth of assets and their ownership by a few.

Most taxes have historically been enacted on the basis of political expendiency without any careful attention to the social and economic consequences of taxes. It is necessary to devise a satisfactory method to determine how differently, unequally situated tax payers ought to be treated which is needed to inspire and sustain public confidence in the fiscal policy of the Government and promote productive efforts and economic growth.

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INDUSTRIAL DEVELOPMENT AND TAX INCENTIVE

The most important objective of all developing countries is attainment of rapid economic or industrial development. In general the obvious requirement for develop--ment is accumulation of capital. Resources for development purposes may be obtained from either internal or external sources or from both. The way of economic development is not along the easy path of low taxation and minimum governmental activity.

Following are the important obstacles to industrialisation -

1. shortage of capital resources.
2. shortage of skilled labour and management
3. inadequate domestic market and limited access to external markets
4. absence of modern technology and science
5. regional imbalance.

Among the steps are required to remove these drawbacks, tax incentives is one of the important measures to remove these drawbacks and to given a push to the industrial development. Similarly fiscal policy needs to be designed to encourage industrialisation in order to :

a) bring about an increase in investments via incentives for both old and new industries.

b) discourage speculative investment in unproductive activities and

c) increase the productivity of the various factors of production engaged in secondary industry. Industrial development can be stimulated by means of tax concessions on reinvested profit in the form of either an exemption from income tax on the amount ploughed back or in reduction in the tax rate. Tax incentives may also be directed at influencing potential investment and sound fiscal devices may be used to encourage the evolution of a local capital market by inducing those with savings at their disposal to participate in corporate industrial enterprises -

1) Shortage of capital resources

There is a general insufficiency of capital reserves in developing countries and their aree several difficulties in mobilising them for industrial development. Foreign investment can often make a significant contribution to resource availability, but domestic savings finance is by for the largest share of industrial investment in a developing country. For industrial development, there should be adequate supply of capital. It means the saving of the people should be diverted in the industrial field. The tax incentives may satisfy this purpose to some extent.

The fiscal policy should provide adequate incentives to the potential investor to divert their savings in the corporate enterprises.

The Income Tax Act provides such incentives.

For example -

a) Deduction is allowed under section 80 CC for making investment in the ordinary shares of newly promoted company.

b) Deduction is allowed under section 80 L in respect of investment and dividends received.

Such incentives divert savings of the people for industrial development. The savings £ of the people can be mobilized for capital formation, not directly but indirectly also.

2) Shortage of skilled labour, management etc.

A lack of skill is frequently the greatest obstacle to industrial development. There is also usually a critical shortage of competent management,there is also absence of modern technology and methods of production, The tax incentives are necessary to import skilled labour, competent management and modern technology. By providing tax concessions, foreign know-how can be used for industrial development.

3) Limited access to external markets

The importance of export market cannot be over-emphasised. The necessary steps should be taken to increase the foreign markets. This is necessary to avoid the problem of balance of payments. Developing countries have limited domestic markets, The industries in the developing countries do not attempt to break into export markets. The need is therefore to provide adequate incentive to promote export market.

4) Science and Technology

A close look at the development of advanced nations would reveal that these nations didn't have any inherent intellectual or physical superiority, but they could succeed due to organised application of science through its technology.

The propensity to develop fundamental sciences, the propensity to accept innovations and the propensity to seek material advances are some of the non-economic factors that influence the rate of economic development. Science and technology can be regarded as a factor of input. The scientific and technolo--gical progress is the prime mover of economic development and hence of industrial development. The tax incentives are necessary to encourage the people to spend money on scientific and technological research.

5) Regional imbalance

The industrial development that took place in India prior to independence and even thereafter was regionally unbalanced. Not only that industry has been largely concentrated in a few developed states, but within them it has been confined to a few metropolitan centres. This problem of regional imbalance is a serious problem the world over. On the eve of independence, apart from the low scale of industrialisation, the spatial pattern of industries showed severe imbalance. About 75 % of the industries were located in 3 major cities namely, Calcutta, Bombay and Madras. While industrial develop-ment at the all India level has been fairly rapid after independence, its spatial pattern has been grossly uneven. Thus this pattern of industrialisation kept backward areas as backward. The tax incentives are necessary to remove this regional imbalance. The income tax Act provides some incentives such as grant of higher development rebate to industries located in backward areas, grant of exemption for income tax for 5 years, after providing development rebate, deduction under section 80 HH or 80 HHA in respect of industrial undertakings established in backward areas or exemption of income tax derived by new industrial undertakings established in Free Trade Zone.

In the context of industrial development, tax incentives do play a positive and help-ful role. With the emergence of the modern welfare state, the role of the states vis-a-vis the citizens has undergone a change and the state is now increasingly looked upon as the provider of welfare to the poorer sections of the population in addition to its normal, traditional functions of maintenance of internal law and order and defence against external aggression. Rapid economic growth with distributive u justice and reduction of inequalities is one of the difficulties arising out of insufficiency of financial resources. The use of scarce resources must be optimised so as to yield maximum results according to national priorities and goals. This is where taxation plays dual role, first, that of raising the resources and, second that of directing economic activity according to these priorities and goals. The revenue function is achieved by the structure, spread and rates of the tax, while the directive function is met by a system of incentives.

Tax Incentives

A tax incentive may be defined as a tax provision which favours a particular types of economic activity or mode of utilisation of the country's resources in preference to others, by giving up totally or partially the tax which would otherwise be chargeable on the production. Besides incentives through the tax system, there are incentives outside of it, such as as subsidies, infrastructure facilities, price preference etc.

Direct incentives are essentially different from those of the 'indirect' incentives provided through the tax system. While direct incentives result in transfer of wealth to the favoured sectors from the rest of the economy, the direct incentives through the tax system do not. They merely permit wealth to remain with the sector which generates it.

Any effort for simultaneous realisation of all the national objectives through taxation would also prove to be a futile and less meaningful exercise. The exact nature of a policy presciption, therefore, has to be guided by the degree of urgency and relevance of a given objective. Consequently, some objectives have to be postponed and may have to be attempted only after the accomplishment of relatively more important ones. Thus, a ranking of the specified objectives becomes imperative and acts as a necessary pre-requisite for designing a country's tax system. It is, therefore, difficult to arrive at a generalized tax system which is capable of meeting all requisites of devloping countries. But since all developing countries share certain similar goals, it is not impossible to evolve some common normative features of taxation. To further the rate of increase in national income, a tax system, besides aiming at a transfer of resources from private hands to public exchequer should incorporate a scheme of incentives aimed at promoting directly an increase in saving and investment of private individuals. Its overall concern should be directed towards maximising savings, mobilising them for productive investment and canalizing them into directions that will best serve the objectives of balanced programme.

Therefore, as V.K.R.V. Rao opines, " the extent to which increments in national income following economic development can get syphoned off into the public exchequer by taxation becomes a crucial factor in the acceleration of economic growth with stability". Accordingly the responsiveness of a tax system to change in national income has been accepted as the guiding principle by the majority of economists. This has followed from the well established thesis that for increasing the rate of investment and saving and setting an underdeveloped economy on the way towards a selfsustaining path of economic growth, it is essential that as large a portion as possible of the increments in income generated by economic development should be channelled into saving and investment. The index that has been adocated to quantity the responsiveness of tax tax structure is the tax to national income ratio. This is evident from this ratios frequent utilization as the dependent variable in all major empirical studies that have been undertaken in recent years to examine the progress that different countries have made in mobilizing the resources required by their respective developmental programmes through taxation. A continuous rise in tax-to-national income ratio has been hypothesized as an indicator of better utilization of taxation.

The large unmber and variety of provisions designed to facilitate and stimulate economic growth in conformity with national priorities and objectives can be grouped into two broad categories: -

1. The first group comprises the general and selective tax concessions of substantial magnitude with the following objectives -

a) Encouraging personal savings and investment

b)

b) Rewarding enterprises and initiative in the field of industrial growth so as to augument the productive capacity of our industry and strengthen its base in various key areas.

c) Strengthening our agricultural base;

d) Promoting our external trade;

e) Encouraging investment in science and technology through research and innovation

f) Encouraging investment in backward areas and many others.

2) The second group comprises the negative incentives or 'disincentives' for example levies and disallowances designed to mop us excessive profits in the corporate sector and unearned increments in personal wealth, discouraging lavish and often wasteful expenditure in trade and industries etc.

Of the incentives provided on a wide ranging and massive scale to the industries, the important ones are those designed to facilitate the inflow of capital, technical know-how and skills from foreign sources which promote the establishment of new industrial processes, encourage, expansion and diversification of existing units and enable industry to make substantial countributions to scientific research and development of new industrial processes, encourage,expansion of foreign trade.

A number of tax incentives have been introduced in recent years with the object of facilitating development of rural areas.

The tax element often excercisd a decisive influence on economic and investment decisions. Reduction or elimination of this influence in the calculations of the viability of a contemplated investment and its cash flow and profitability can make all the difference between deciding to go ahead with it, or giving it up. This is the function of the tax incentives.

For instance, as between a steel plant and a unit making soaps, cosmetics etc., the choice from the country's point of view would be a steel plant which would strengthen the industrial base, but the businessmen may prefer another unit (soap or cosmetics units) because it would yield greater profit within a shorter period. By neutralising the disadvantages of low profitability and long waiting periods of the steel plant, tax concession can make an investment in it worth. The development rebates provides a classic example of this aspect of tax incentive, as it was being allowed at the higher rate of 35 per cent of the cost of plant installed in specified priority industries but also at the rate of 20 per cent in the case of other industries.

In our direct taxes laws, a vast range of incentives specifically designed to set up and carry on new ventures as well as to enable the existing industries to have increasing productivity has been provided for. The allowances or the incentive are available both in the income tax Act 1961 and wealth tax Act 1957.

In the chapters that follow, an attempt has been made to evaluate some of the selected tax incentives.