Rediscovering Kaldor?

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The Pundits who had rejected outright his recommendations for a comprehensive tax reform now seem to be re-discovering Kaldor. They now seem to find considerable virtue in what Kaldor had said rune years ago, although at the time they saw nothing but mischief in it.

One cannot quarrel with those who have had a real change of heart, i.e., those who now genuinely believe that Kaldor’s recommendations for tax reform will do the country good. It is those who drag him in disingenuously, and quote him out of context to reinforce their own point of view that need to be exposed.

Support for the case for lowering the existing rates of individual and corporate taxation is sought by referring to Kaldor’s proposal that the maximum rate of tax on income should not exceed 45 per cent. The Financial Editor of a well-known daily takes this proposal of Kaldor to mean that direct tax burden be restricted to about 45 per cent. Does it really?

KALDOR suggested a ceiling of 45 per cent for income taxation not because he thought that a marginal rate higher than 45 per cent would militate against economic growth, granting that he attached great importance to maintaining economic incentives, but because he strongly believed that “instead of placing the main weight of progressive taxation on a single tax the income tax (it is proposed that) progressive taxation should be levied on a number of ‘yardsticks’ of taxable capacity like total wealth, income, expenditure, etc.” The adoption of a comprehensive tax base would, he had argued, “augurate a more truly equitable and progressive tax system, as well as bring in a great deal of additional revenue.” In fact, it can be demonstrated fairly easily that at the level where a tax payer is liable to the highest rates of tax on income, wealth and expenditure, etc. One cannot quarrel with those who have had a real change of heart, i.e., those who now genuinely believe that Kaldor’s recommendations for tax reform will do the country good. It is those who drag him in disingenuously, and quote him out of context to reinforce their own point of view that need to be exposed.

The position in India is precisely opposite to that in America. What is old fashioned in America might therefore be quite the thing to do in the Indian situation. The problem here is to create larger and larger supply potential, agricultural as well as industrial, with a view to meeting expanding final demand.

And then why do these Pundits not refer to the additional tax cuts that President Johnson now wants to make? He has given firm notice that he intends cutting down excise duties. Why? Because his economic advisers have told him that a dollar restored to the tax-payer through reduction of excise duty stimulates final demand much more strongly than a dollar restored through a cut in the rate of income tax.

Case for Tax Cut

All this should not be taken to mean that there is no case at all for reducing the existing rates of income-tax on individuals and even companies. And Kaldor’s support can genuinely be invoked. Kaldor regarded it as a major consideration of tax policy “to prevent the tax system from becoming too much of a disincentive on effort, initiative or enterprise.” He said in no uncertain terms that he regarded high marginal rates of 80 to 90 per cent to the “wholly pernicious” in their disincentive effects on work, saving and enterprise. That is why he suggested a combination of a moderately progressive income tax with the highest marginal rate of 45 per cent, with an expenditure tax whose highest rate would be 300 per cent and a wealth tax whose highest rate should be 1.5 per cent.

As things stand today the highest marginal rate of the expenditure tax will be 20 per cent (it is 15 per cent until the end of the current expenditure-year) but the highest wealth tax rate is 2.5 per cent. On the basis of the same assumptions that yielded the total marginal direct tax burden of 90 per cent for Kaldor’s package of three direct taxes, it does appear that to keep the total direct tax burden at the same level the highest marginal rate of income tax should not exceed 54 to 55 per cent. Let us straightaway concede however that under a different set of assumptions, particularly with regard to the typical rate of return on capital earned by income groups to whom the highest marginal rate of wealth tax applies, a higher rate of income tax might be justified. May be, one could argue, for a ceiling rate of 65 per cent. But on the assumptions Kaldor’s own proposals would impose a total direct tax burden lower than 90 per cent.

In any case, it is clear that the existing high marginal rates of income tax on individuals ought to be scaled down. And the very first measure (which ought to have been taken alongside the imposition of the wealth tax) is the complete abolition of the surcharge on unearned income. There is absolutely no justification for its continuation. This step should itself bring down the marginal rate of tax from the present 88 per cent to 82.5 per cent. And if alongside, the surcharge of 10 per cent on earned income in excess of Rs 1 lakh is also abolished, the highest marginal rate would settle at 75 per cent. This is the minimum that we would urge the Finance Minister to do in the Budget due next week.

As regards the rate of tax applying to companies, while there is a case for reducing it to 45 per cent for all companies, there is a much, much stronger case for reducing it to a distinctly lower level for small companies from the existing 42.5 per cent, which, to say the least, is ridiculously high for a company whose income is Rs 25,000 a year or below. In com-
parison, a US corporation with income of $25,000 or below pays just 14 per cent by way of income tax. We feel that the lower rate should apply to all companies, public or private, with suitable safeguards against abuse in the case of private companies.

New and small companies deserve to be treated differentially from both the social and economic points of view. Right now, the position of new concerns is that they can avail themselves of either tax holiday or developmental rebates since both run concurrently. While there is a very weak economic case for giving developmental rebate in an economy short of capital or suffering from large-scale unemployment, there is a strong case for a more liberal tax holiday. The present ceiling of 6 per cent on tax exempt profit is rather low compared to what other under-developed countries are offering. Also, following Kaldor, one could argue against a tax on dividend. If, on the other hand, one subscribes to the view that some tax differential in favour of corporate retention is necessary to have, the appropriate thing to do would be to revert to the old practice of giving rebate on the standard rate.

Details are important. But more important is the fundamental issue: the reconciliation of the objectives of growth and equality in such a way that growth is not sacrificed for equality that cannot be effectively enforced. The Budget this time provides the Finance Minister an opportunity which very seldom comes by. Let us hope he will take it with both hands.