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Is VDIS a success?

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The Voluntary Disclosure of Incomes Scheme [VDIS] closed on December 31, 1997. The time is thus opportune to address this question squarely. The answer to this question depends on another question: What was the objective of Introducing VDIS? The objective itself may be wrong or right. But the scheme can be considered a success if at least the pronounced objective was fulfilled.

Alas, the objective has never been stated by the policy makers. But their various statements and speeches suggest that the objectives were one or more of the following three: (1) to collect revenue, (2) to widen the tax net, or (3) to tackle the problem of black money by harnessing it for productive purposes. Let us examine these in turn.

To collect revenue: Here again, we were never told that if revenue collected through VDIS were, say, Rs.5,000 crores or more, it will be treated as success; if less, it will be deemed a failure. In the absence of any specific target of revenue, whatever may be actual collection, the official spokesmen can conveniently say that the amount was much higher than expected, and therefore VDIS was a success; and detractors can always conclude that amount was paltry and therefore the scheme was a failure.

My view is that irrespective of how large was the revenue collected, the scheme cannot be possibly considered a success on this count. Let us take a very liberal illustrative figure of Rs.7,000 crores as revenue collected under VDIS. This represents approximately Rs.22,000 crores of concealed incomes disclosed. Out of this 77.5% (or about Rs.5,500 crores) is to be distributed among the States; and Rs.1,500 crores will be left for the centre. The UF Government being dominated by regional parties, the Finance Minister's anxiety to distribute this largesse among the States may be politically understandable. Economically it is very weak. State governments can all be counted upon to use this one-time receipt as an excuse to finance increased revenue expenditure; in fact to think of newer expenditure heads. The leakages inherent in this are too well-known, to need elaboration here. Moreover, the formula to be used for this 'devolution' will in probability favour the States, which are already in a financial mess; and not the relatively less-mismanaged States where there are better prospects of these funds being used for some productive capital expenditure. The States should have

demanding that the devolution should be in proportion to the VDIS collections for the respective States.

Consider next the Centre's share of Rs.1,500 crores. The Finance Minister promised in his Budget Speech that this amount will be utilised 'towards financing the Basic Minimum needs services programme and infrastructure needs'. In other words, whatever expenditure has been provided for in the Budget on these two counts will be increased to the extent of the Centre's kitty from the VDIS collections. All economic analysts – Indian and foreign have repeatedly highlighted that our fiscal mess arises primarily due to the runaway expenditure which is financed by excessive borrowing. If only the Finance Minister had promised that every rupee from the VDIS collections

will be used to retire a part of Rs.3,68,682 crores internal debt and thus to reduce the interest burden of the national debt by about Rs.700 crores per year, he would have deserved all round support. In that way, the dishonest black money wallahs would have at least helped indirectly to reduce the burden of honest tax payer. But the Finance Minister has actually promised to increase perpetually the government expenditure. Thus in the future years, in the absence of another VDIS, this increase will have to be financed by additional tax burden or additional borrowing year after year. The scheme of VDIS is such that the larger the collections, the messier will the fiscal problem become. I cannot possibly support it.

Incidentally, the budgeted fiscal deficit for 1997-98 is Rs.65,000 crores. All subsequent developments indicate that in fact the deficit will be no less than Rs.70,000 crores. VDIS revenue left for the Centre at Rs.1,500 crores is, even otherwise, too paltry to have any impact on the deficit. The main point is that the Centre's VDIS kitty is not meant to have any impact on the deficit. It is meant as a tool to increase government expenditure perennially. That is obviously the reason why the Finance Minister refused to take any credit in his 1997-98 budget calculations for any amount from this kitty.

Another (alternative) objective of the VDIS could be to widen the tax net. I remember that in a meeting in Bombay the Finance Minister explicitly stated that he was not so much concerned with the amount collected under VDIS, he was interested in widening the tax net, as this would improve tax collection in future years. Out of the reported one lakh twenty thousand VDIS declarants it will be naive to assume that many were filing any I.T. returns for the first time. It is more likely that most of them were filing returns but were grossly under-

reporting their real income. In this sense, VDIS will not widen the tax net, it may probably deepen the existing tax net.

Incidentally again, the Finance Minister also introduced in the Budget another scheme of expenditure based presumptive tax (car, foreign travel, flat, etc.). It was reported that about 60,000 new assesseees have joined the Income Tax payers' 1.2 million strong tribe as a result of that scheme. This response is again too insignificant; but that scheme at least has a potential of widening the tax net. Not the VDIS.

Moreover, for 'widening' the tax net, a low marginal tax rate is more relevant. If 30% is considered low enough, that should do the trick. We do not need an awards giving ceremony for past sins for it, which is what VDIS is.

Finally, the objective of harnessing black money for productive purposes. This is a large and complex subject. But a few points need to be underscored.

(1) More than ten years ago, the Government of India had commissioned a study by the National Institute of Public Finance & Policy, New Delhi (NIPFP) on various aspects of the black money problem. One of its findings was that black money (incomes) was about 18 to 21% of GNP. Some analysts have felt that this estimate is too low and black money could be about 50% (if not more) of the GNP. Has the percentage gone down or gone up from whatever level it was then? There has been no such subsequent study. To give ample benefit of doubt to the authorities, let us proceed on two assumptions: First, that the NIPFP estimate is reasonable. Secondly, in view of many economic policy measures taken after 1991 (notably, lower tax rates, decontrols and deregulation, more realistic exchange rates, gold imports, higher salaries to bureaucrats etc. etc.) the percentage has probably gone down to some extent and that black money generation currently is about 10% of GNP. [I know, many serious thinkers will laugh at both these assumptions].

With GNP at about Rs.12,600 abja (or billion), the black money being generated would be Rs.12,600 crores per year. Assuming that Rs.22,000 crores of black money is disclosed under VDIS; this means that it will take the Indian economy barely two months to generate black money equivalent to the amount disclosed under VDIS.

(2) The VDIS disclosures are for concealments over past years; that is VDIS will disclose black wealth being amassed out of black money incomes earned year after year in the past. The figure of total black wealth will be many times higher.

(3) It will be incorrect to assume that black money earned is all lying idle. No Sir. Not only does the 'system' have its own effective laundries, but even otherwise black money is very much 'in use' and for all we know, used 'productively' from the money earners point of view. And some black money has to be kept black because there are numerous transactions where only black money will do. (You can't give bribes by cheques, and you can't declare bribes taken in your I.Tax return, howsoever low the marginal tax rate may be). Ditto with large parts of election funding.

(4) The problem of black money has two facets: We must clear the dirty pool of accumulated black wealth and we must stop the streams of black money that add to the pool. VDIS at best is a cosmetic remedy aimed at the pool. But the problem can never be tackled unless the fresh streams are stopped, by removing the causes that generate black incomes.

(5) The same NIPFP study had highlighted in no uncertain terms the devious role of government expenditure as a major source of generation of black money. To quote:

"For most substantial public sector contracts, whether placed at home or abroad, significant cuts and kickbacks to key decision makers has become the rule rather than the exception. The relative scale of this form of corruption – leakages from public expenditure – has grown substantially over the past two decades and is believed to have become an important source of unaccounted funds for political finance of elections and inter-election political manipulations".

The VDIS scheme does nothing to reduce government expenditure. In fact, as stated already, it ensures a perpetual increase in government expenditure and thus unwittingly helps in aggravating the problem of black money.

The conclusion is thus inescapable that the VDIS will not and cannot achieve any of its own pronounced objectives. Each of these three objectives are of course laudable and worth striving for. And, luckily they are far better and just instruments of economic policy available for achieving them. But that is another story.

Will the VDIS at least achieve something else worth achieving? Who in society will benefit or who will lose by the VDIS? Here too the reply is surely discouraging.

The tax evaders of course have had a field day. As if the rewards offered to them in the scheme were not seductive enough, the government went on issuing explanations and clarifications after the scheme was introduced in such number and sweep that, with the able help of one's obliging chartered accountant, it became possible to get away by paying practically no tax at all. Many are believed to have disclosed far in excess of the truly

concealed incomes, so as to provide for the future and the press kept on reporting of super ingenious ideas exhibiting a shameless greed on the part of the 'declarants'. Many among the jewellers, lawyers and tax consultants too have had a field day, as VDIS became a lucrative industry, and honest tax payers watched it all with dismay, anger and helplessness. The Government's concern for '100% peace of mind' for tax evaders was touching. It had to be; tax evaders would not settle for anything less than 100%. Has the government shown one tenth the concern for at least 50% peace of mind of the honest tax payers? I met quite a few tax payers who seem to be honest; but not one who is not disgusted with the harassment meted out to them by the I.T department. It is not without reason that respected Indian experts routinely describe the Income Tax Act as a 'national disgrace' and the I.T. department even in official circles is considered to be in shambles.

The economic and fiscal system should, at its best, reward the honest and the enterprising while at the same time eliminate or punish the dishonest. If the system is unable to achieve this, it should resign to being indifferent to the dishonest. But a system manifested by the VDIS which demoralises the honest with extra financial burdens and a loss of peace of mind, while at the same time it makes dishonesty time and again, a more and more rewarding and peaceful enterprise is a system with a bleak outlook. Such a system can do no good to the country.

The best part of the VDIS is the assurance that government spokesmen have been giving that this is the last of such a schemes and it will not be repeated. I have my own doubts of course. To be cynically frank, I have actually no doubts that another and yet more attractive scheme will one day be born under this garb or that. I am not looking forward to that day.

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