Chapter I Introduction, Concept, Definition and Purpose of the Study

1. **Background of the Indian Economy**: India is a vast country having an area of 32,87,263 square kilometres and a population of 843,930,861 on 1st January, 1991.

2. India is an over populated developing country and has made considerable progress in all fields since planning started in 1951.

3. **Before Industrial Revolution and establishment of British rule**, India was a manufacturing country. Our handicrafts declined because they could not face the competition of machine made goods and the British rule twisted every thing to suit Imperial interests at the detriment of interests of the Indian economy.

4. Consequently, we find heavy dependence on agriculture, surplus labour in agriculture
and a static occupational structure which has not changed much during last 70 - 80 years.

5. The capacity of organised sector to absorb labour is limited as such India's teeming millions will have to find jobs in the Informal Sector in non-agricultural sector in the years to come.

6. Agriculture produces 41.6% of national income, secondary sector produces 29.9% and residual 28.5% of national income originates in services.

7. Organised sector is Modern Sector, Large Scale, uses modern technology, covers modern industry, trade, commerce, banking, electricity, gas, water supply, Defence and Public Administration. Organised Sector also includes modern educational institutions, hospitals, financial institutions, multinationals, big hotels, public sector and research institutions. This sector of the Indian economy is as advanced as its counter part in any other advanced country of the world.
8. Exactly opposed to modern, organised, large scale sector is informal, unorganised sector in agriculture, trade, manufacturing, transport and services. The informal sector uses traditional technology, operates on small scale, does not maintain records, employs unskilled, uneducated labour which may sometimes be family labour.

9. W. Arthur Lewis' Hypothesis on Surplus Labour that after the transition stage everything will become organised - does not seem to be correct. The Informal Sector is making its presence felt in advanced, developed countries like U.S.A., U.K., Canada, Western European countries also. As such the informal sector cannot be taken for granted to get converted into modern, organised, developed sector automatically in the course of transition of the economy from traditional to developed economy. Economic policy has to take cognizance of its existence, importance as well as role and make conscious effort to utilise it as a resource of growth, rather than an Engine of Growth. This is particularly true in
case of India.

10. The Informal Sector is outside the purview of the law relating to labour, social security, welfare and taxation.

11. **Definition of Informal Sector:** The Informal sector is characterised by small scale, family ownership, inferior technology, self employment, non-maintenance of records, low skilled labour.

12. The informal / unorganised sector is spread in each and every economic activity both in rural and urban areas, it covers agriculture, petty production, trade, animal husbandry, cottage industries, services, mining, construction etc. Because it is not possible to do justice to all these activities, in one Ph.D. Thesis, it is proposed to leave agriculture out of the scope of the study and the main focus of the thesis is on **UN-ORGANISED MANUFACTURE.**

13. For the purpose of this study the unorganised
sector is defined as enterprises employing 9 or less than nine workers and as a residual offormal/organised/modern/Large Scale Sector. This definition has been suggested keeping in mind the available data on production and revenue of products of Informal vis-a-vis Organised Sectors so as to enable us to compare the tax burden, examine each item on merits and make recommendation about tax relief and / or additional taxation on each items on merits.

14. **Data Sources:** The Sources of data about Employment, National Income and Taxation are given in Annexure I. Of course, the source of data on National Income is White Paper on National Income published by the Central Statistical Organisation, Department of Statistics, Government of India. Data on Employment is taken from relevant rounds of National Sample Survey, Population Projections, Employment Market Information, published
by Directorate General of Employment and Training, Ministry of Labour, Economic Censuses by C.S.O., Directory and Non-Directory Manufacturing Establishment Surveys / Censuses by C.S.O./ N.S.S.O. conducted during different years. Data about taxes is taken from Budget Papers, Speeches of Finance Ministers, Reports on Currency and Finance, Economic Survey, Annual Reports of Administrative Ministries, information received from Manufacturers' Associations both in the Small as well as Large Scale Sector. Specific reference to these sources of data has been made at appropriate place in the Thesis while discussing tax incidence on different items / economic activities.

15. Limitation of Data: (i) The incomes are grossly understated, the value of output of Census of Small Scale Industries conducted during 1972-73, N.S.S., 29th Round 1974-75, Economic Censuses 1977 and 1980 seem to be unrealistic in view of time lag, change in composition of industrial output.
and inflation since the time these censuses/surveys were conducted. It is not easy to get value of output of an item manufactured in Unorganised vis-a-vis organised sectors and relate the same to Revenue figure published in Budget papers because of clubbing of different stages of production for one item and clubbing of different items together for which merits are different for each item.

(ii) The published revenue figures do not reveal the breakup of yield from Large Versus Small Scale on different items.

(iii) Detailed statistics about Glass, Food Processing, Electronics are not available which prevents detailed examination of tax incidence within one item.

(iv) Different Government agencies dealing with data, revenue and production may work in harmony with one another and publish more detailed, comparable and uniform data which will go a long way in benefitting planners, policy makers and researchers and will result in better understanding of the Indian Economy.
16. **(i) Scope and Methodology:** It is not possible to do justice to India's vast unorganised sector in one Ph.D. Thesis as such agriculture is left out of the scope of the study and main focus of the thesis is on UNORGANISED MANUFACTURE.

**(ii) Tax incidence on different items and overall on different products of Small versus Large Scale Sector as a percentage of value of output is considered on merits of each case, according to Ability to Pay and Benefit Principles and accordingly case is made for additional taxation or tax relief.**

17. **Objectives and Hypothesis:** (i) A large part of India's national output goes untaxed or is taxed at very low rates because of tax exemptions, other financial benefits and incentives provided at the expense of the Indian Tax Payer. This narrows the tax base. Is it worth to do so is the question the Thesis has posed and tried to answer.

18. **The Informal Sector is important in the**
Indian Economy. We have to tap its tax potential, give it selective help and utilise it as an Engine of Growth in the interest of overall development of the Indian Economy in order to maximise economic welfare of the Indian people.

19. Case for Additional Taxation or Tax Relief on each item is discussed at length on merits and economic principles.

20. On the basis of data, facts, economic principles, it is estimated that Rs. 7684.23 crores or Rs. 4980.43 crores will flow annually into India's treasury every year as a result of Taxation of Informal / Unorganised Sector in India.

Chapter II.

21. India's Occupation structure is still heavily dependent on primary sector - 68.8% of workers are engaged in agriculture, 13.5% in secondary activities and the rest 17.7% find jobs in tertiary sector.

22. Organised Sector employs 10.29% workers
and the rest 89.71% find jobs in informal sector in 1981.

23. According to latest available data organised employment is 8.32% and the rest 91.68% of workers find jobs in the unorganised sector.

24. During 1984-85, unorganised sector generated 62.25% of net value added whereas organised sector generated 37.75% of net value added.

25. Even if we exclude Agriculture, the unorganised sector is the main source of employment and national income in India generating 47% of net value added and employing 68.92% of labour force.

26. The role and significance of the informal sector is expected to increase in the years to come.

Chapter III

27. After a Bird's Eye View of the Indian Fiscal System, Role of Fiscal Policy in general,
the Chapter elaborates the exemptions to Unorganised Manufacture since Second Five Year Plan.

28. (i) One kilogram of toilet soap manufactured in organised sector has tax element / tax burden at the rate of 28.75% of value of output. Tax burden on toilet soap manufactured in unorganised sector has tax element varying between 8.75% to 3.75% of value of output. Laundry soap is mostly manufactured in the unorganised sector and has a tax element of 4.5% of value of output. As such there is a case for additional taxation of laundry soap which should fetch an additional revenue of Rs. 120 crores.

(ii) Synthetic Detergents manufactured in the organised sector have a tax element of 35% of value of output, whereas the same synthetic detergent manufactured in unorganised sector has tax element of 15% of value of output.
29. (i) An export duty of 10% on leather and leather goods will fetch Rs.114.85 crores annually.
(ii) Excise and Sales Tax at the rate of 5% each on leather and fur products will fetch Rs.38.80 crores annually.

30. (i) Slight Excise or Sales Tax on Khandsari and gur using about 41% of the total sugar cane produced in India can fetch a revenue of Rs.50 crores every year.
(iii) Molasses by Khandsari manufacturers is free of excise and is misused for illicit distillation on which again no excise or sales tax is paid. There is no valid reason for not taxing molasses produced in khandsari units. Slight tax may fetch at least 5 crores annually to the exchequer.

31. Tax burden on cottage match is 3.05% of value of output whereas the tax burden on match in mechanised sector 12.5 %; Semi-mechanised sector is 8.33% and in Non-mechanised sector is 6.94% of value of output. Match box sells all over India at 25 Paise per
match box. There is case for slight upward revision of duty on cottage match to the level of non-mechanised sector so that we get an additional revenue of Rs.11 crores even though match is a wage good, it will generate inflationary pressure and resentment from people.

32. Taxing all edible oils may fetch Rs.75 crores annually and Taxing all oilseeds at the rate of 10% may fetch Rs.493.40 crores annually. This will reduce demand for edible oils, there will be less pressure to import edible oils. Moreover, oils are needed to a limited extent in food and excessive consumption of edible oils is health hazard, it leads to heart disease and unhealthy accumulation of fat in human body. A citizen in Europe or America consumes much less edible oil than an Indian consumes in traditional food.

Textiles:

33. (i) Powerloom cloth may be taxed at 10 paise per metre to give a revenue of Rs.64.57 crores every year.
(ii) In silk there is a case of helping the producer to produce more silk but taxing the consumer. Slight tax can fetch Rs. 25 crores.

(iii) Tax burden on manmade and synthetic fibres is too heavy, there is a case for tax relief so that more people get jobs in producing manmade fibres and people get synthetic cloth to wear.

(iv) Tax on woollen textiles is 20% of value of output which seems to be too high. After all woollens are basic necessity of life. There is case for tax relief and helping sheep rearing in hills to produce finer quality of raw wool.

Chapter IV - Tax Incidence, Capacity to Pay and Benefit Principles

34. Bidi Industry deserves to be taxed because of low tax yield and being injurious to
health. Slight tax and strengthening of tax machinery can easily fetch Rs. 110 crores to the exchequer. This seems to be essential to reduce the demand for tobacco, tobacco products, biris etc., manufactured by unorganised sector. The consumers of biris should pay for the demand they will be making on public health services any day.

35. Low incidence on Unorganised Manufacture.

36. Concept of Tax Exemptions/Expenditures/Incentives.

37. Scheme of Tax Exemptions in India, its rationale and justification.

38. Case for gradual abolition of Tax Exemptions in India.

CHAPTER V

Intra-Sector Differences in Tax incidence within the Unorganised Sector.


40. Plastics.

41. Hosiery Industry

42. Readymade Garment Industry

43. Food Processing Industry

44. Electronics
45. Bicycle
46. Sewing Machine
47. Glass and Glasswares
48. Tax Exemptions not justified
49. Tax Expenditure Budget in Centre, States and Local Bodies.

CHAPTER - VI

Tax Potential and Subsidy Requirements of the Unorganised Sector.

50. There is no justification for reducing the tax base due to tax exemptions.

51. The Small Scale Industries should be Self-Reliant, not dependent on State help for ever.

52. Tax Exemptions not justified on the basis of modern economic analysis.

53. Time is ripe for gradual abolition of Tax Exemptions – we may start with luxury items in the first instance.

54. A large part of India's national output goes untaxed or is taxed at a very low concessional rate.

55. Unorganised Manufacturing Sector should repay the benefits it has received at the expense of Indian tax payer.
56. Taxation of unorganised construction may fetch Rs. 457 crores annually or Rs. 925 crores as per two alternative estimates presented in Table VI.1.

57. Unorganised Transport can fetch Rs. 250 or Rs. 402.80 crores every year to the exchequer according to two alternative estimates.

58. Taxation of Trade, Hotels and Restaurants in the Informal Sector can fetch Rs. 2500 crores every year or Rs. 3958 crores according to two alternative estimates.

59. Unorganised real estates, ownership of dwellings and business services has a tax potential of Rs. 383 crores or Rs. 984 crores as per two alternative estimates.

60. Services Sector has to be disaggregated, highly skilled workers have a tax potential.

61. Illicit distillation has a tax potential of Rs. 500 crores.

62. Tobacco manufactured in the informal sector has a tax potential of Rs. 110 crores.

63. Real Estate, ownership of dwellings and business has a tax potential of Rs. 3621 crores or Rs. 6324.80 crores as per two alternative estimates presented in Table VI.1.
64. The unorganised/informal sector has a tax potential of Rs. 4980.43 crores or Rs. 7684.23 crores as per two alternative estimates presented in Table VI.1.

Subsidy requirements of the Unorganised Sector.

65. Traditional cottage and village industries using primitive technology have low productivity and poor efficiency. They have a small value added per worker. Each economic activity should be self-reliant, efficient, productive and should be able to stand on its own feet.

66. Any employment should not be dependent on the patronage of the State for subsidies, rebates, tax exemptions, financial and other benefits.

67. Subsidies, tax exemptions, financial help etc., do not help in development; rather they make the entrepreneur lethargic, less efficient and dependent on State help for ever.

68. Concessional bank advances make the firms to use more capital per unit of labour and output.

69. Tax exemptions give incentive to firms to remain small on paper to take advantage of tax exemptions rather than expanding the firm and have economies of scale.
70. Time is ripe now for abolition of all tax exemptions, subsidies, rebates, financial and other help. Let each economic activity stand on its own feet.

71. Each economic activity should be efficient and productive.

72. Village artisans, self-employed workers, petty producers may continue to be helped to become efficient and productive. Same is the case with items earning foreign exchange.

73. Endeavour of the State policy should be to help the unorganised sector to grow, be efficient, productive and have "Ability to Pay" and have taxable capacity to pay for the 'Benefits' it has received from the State at the expense of the Indian tax payer. The small scale sector has a moral and social obligation to repay the concessions received to the society by increasing its efficiency and productivity.