

The Perversity of the Neo-liberal Fiscal Regime*

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When income growth slows down in an economy, so does the growth of tax revenue within the given tax regime. Since the government has certain expenditure obligations, to meet these obligations it has to either impose additional taxes or expand its fiscal deficit. Enlarging the fiscal deficit in such a situation, which was the typical response everywhere under post-war capitalist dirigisme, has the additional effect of ensuring that one component of demand, namely that arising from government spending, remains unchanged, even as the economy is otherwise slowing down, thereby checking this slowdown itself. This was referred to in economics textbooks as the economy's having an "automatic stabilizer": government expenditure under these circumstances acted as an "automatic stabilizer" and served to restrict the downturn.

All this was under the earlier dirigiste regime. Under neo-liberalism however matters are completely different. When tax revenue collections under the neo-liberal regime slow down because of the slowing down of the economy, the government can neither impose additional taxes on the capitalists (imposing additional taxes on the working people to finance its expenditure does not add to aggregate demand and hence does nothing to arrest the downturn), nor expand the fiscal deficit. This is because both these measures will be opposed by international finance capital which would start a capital flight within the liberalized regime, causing a hurtful financial crisis.

In fact since virtually all countries with the exception of the United States have adopted laws restricting their fiscal deficits to 3 per cent of the GDP (in India the Centre and the states have each a limit of 3 per cent), with the slowing down of the economy there has to be a slowing down not only in the growth of the tax revenue but also in the fiscal deficit and hence in the total public expenditure.

Within a neo-liberal regime therefore public expenditure does not act as an automatic stabilizer, as it had done earlier. When the growth of the economy slows down, so does the growth of public expenditure, thereby further contributing to the slowing down of the economy. This is sometimes referred to as public expenditure being "pro-cyclical" rather than "anti-cyclical" (which is somewhat misleading because it suggests that the crisis is always a cyclical crisis).

This is the crux of the perversity of the fiscal regime under neo-liberalism, namely that it removes what otherwise would have been a bulwark against the slowing down of the economy, by enjoining so-called "fiscal responsibility" upon all governments; it thereby compounds the process of slowing down.

Against this basic background, governments of course resort to all manner of subterfuges to wriggle out of the predicament in which they find themselves. We are currently witnessing in India two such efforts. One consists in the central government's squeezing the states, passing on the burden of its own fiscal crisis on to the shoulders of the state governments, even violating its Constitutional obligations; the other is its mad rush to privatize the public sector, in an utterly reprehensible short-sighted bid to get some money within the constraints of a neo-liberal economy. Let us look at each of these seriatim.

One way in which the Centre is trying to squeeze the states, by off-loading a part of defence expenditure on to their shoulders, has already been discussed in this column (PD, September 1). Defence is exclusively in the “Union List” of the Seventh schedule of the Constitution, which means that the Centre has exclusive responsibility to spend on defence and to decide on all defence matters. But the Central government has asked the Fifteenth Finance Commission to deduct defence expenditure from the divisible pool, which means that the state governments are being asked to bear a part of this burden, even though the Constitutional arrangement with regard to the Seventh Schedule remains unchanged and all decisions regarding defence will continue to be taken by the Centre alone.

But this at least remains a threat until now. In another area however the Centre has already squeezed the states, and this relates to GST compensation. When the Goods and Services Tax was introduced, in order to persuade the states to agree to it the Centre had promised to compensate them for a period of five years for any revenue loss that they may face. The revenue loss was to be calculated by taking a base revenue level and applying to it a 14 per cent annual rate of growth in nominal terms; whatever was the shortfall from the revenue estimated in this manner was to be compensated by the Central government. This was to happen every two months and a Compensation Cess Fund was set up for this purpose into which the revenue from certain taxes was supposed to go.

But the Central government has stopped making any such compensation payments from August onwards. Its argument is that there is not enough money in the Compensation Cess Fund. The states, however, point out, very correctly, that the promise to pay compensation to the state governments was not linked in anyway to the size of the Compensation Fund; it was a stipulation contained in the Constitution Amendment bill. If there is no money in the Compensation fund, or not enough, then the Centre should pay compensation out of its own share of the GST revenue.

It is well known that there has been a substantial revenue short-fall on account of the GST, with the monthly revenue falling below Rs.1 lakh crores for most months of the current financial year. This shortfall is both because of the flawed nature of the GST itself and also because of the slowing down of the economy. The fact that GST collections for November, which falls within the festive season, were marginally in excess of Rs.1 lakh crores, is because GST revenue is closely related to the magnitude of business turnover, and hence to the level of activity in the economy.

Faced with this revenue loss, the Central government is squeezing the states, going back on its own promise of making good their revenue short-fall, in a bid to keep its own head above the water. In addition, out of the Integrated Goods and Services Tax (IGST) collections, which are to be shared between the Centre and the states, the Centre has kept the lion’s share for itself.

Because of this double squeeze, the states are in utterly dire straits. Since much of the welfare expenditure going towards the poor comes out of state revenues, a shrinking of such revenues has a direct effect on welfare expenditure, including on healthcare, and education.

All this could have been avoided if the Central government had not squeezed the states, but had stuck to its promise of making good the revenue short-fall for the

states, and enlarged the fiscal deficit for this purpose (the fact that it never had the gumption to tax capitalists is amply shown by its recent measure to actually give them tax concessions). An enlargement of the fiscal deficit would have boosted aggregate demand and hence employment and output, without having any inflationary consequences. True, inflation in the economy is creeping up of late, but that has to do with specific sectors (onions being one example) and requires specific measures of supply management (through the use of the Public Distribution System); raising the fiscal deficit in such a situation would scarcely have led to an acceleration of inflation, once such specific supply management measures were in place.

But such an enlargement of the fiscal deficit would be unacceptable to international finance capital; and the Modi government, with all its bluster against hapless minorities within the country, and with all its pretensions to machismo, has no stomach for standing up to finance capital. It would rather squeeze state governments, it would rather see a cut in welfare expenditure directed towards the poor, than take measures frowned upon by international finance capital. It is a mere conduit through which the dictates of finance capital are made to impinge on the economy, and the perversity of the neo-liberal regime makes itself felt.

The second way, apart from defrauding the states of their legitimate share of resources, in which the Centre is attempting to cope with the fiscal squeeze, which it has become subject to under the neo-liberal regime, is by privatizing a whole range of public sector enterprises.

Not a day passes without the government announcing some measure of privatization. Minister Hardeep Puri claims that Air India has to close down if it is not privatized, a remarkable statement by a senior government functionary for two reasons: first, if the private buyer is supposed to be able to revive the company (for otherwise why should anyone be buying it), then why can't the government do the same? Secondly, even if one accepts for argument's sake that what Puri says is correct, his saying so is most bizarre because it amounts to a signal to potential buyers to scale down their bids for it. A large number of public sector enterprises in the Asansol-Durgapur belt of West Bengal are being sought to be privatized, riding roughshod over the demands of the trade unions. BSNL employees are being more or less forced to accept voluntary retirement, so that the company can no longer remain viable and would have to be sold off. Such examples can be multiplied.

Of course the BJP government, with its total lack of understanding of the significance of the public sector and also with its closeness to the corporate-financial oligarchy, is prone to dismantling the public sector anyway. But now it feels an added urgency for doing so in order to cope with the fiscal squeeze that the economic downturn has brought in its wake.

To stimulate privatization, international finance capital (and its leading institutions like the IMF and the World Bank) have resorted to a fiddle, namely to exclude the proceeds from the sale of public sector assets from the fiscal deficit; the government can therefore show a smaller fiscal deficit figure, one conforming to the "Fiscal Responsibility" target, by selling public sector assets. This is a completely illegitimate practice, but it is done for ideological reasons, for effecting privatization.

The reason why it is illegitimate is quite simple. A fiscal deficit of course has none of the ill-effects on the economy that spokesmen of finance capital claim it has, in a demand-constrained economy, i.e. in an economy where there is unemployment and unutilized capacity: it neither leads to any “crowding out” of private investment (since there is no “fixed pool” of savings from which the private sector gets less because of the fiscal deficit, as savings themselves increase with the rise in income that occurs in response to the rise in aggregate demand that is generated by the fiscal deficit); nor does it lead to any inflation, since the economy is characterized by unemployed resources so that a rise in aggregate demand causes an output increase rather than a price-level increase. But even assuming for a moment that a fiscal deficit has all the ill-effects that spokesmen for finance claim it has, the proceeds from privatization do not eliminate those ill-effects.

If for instance there were indeed a “fixed pool” of savings, from which, if the government borrowed more to finance a fiscal deficit, less would be left for the private investors leading to a “crowding out”, this “fixed pool” will not increase an iota by the privatization of public sector assets. Likewise, suppose the fiscal deficit would indeed be causing inflation by creating excess demand, then privatizing public sector assets would not reduce this excess demand an iota, since the buyers of these assets would not be skimping on their demand for goods and services for purchasing public sector assets.

Thus the sale of public sector assets does not actually close any fiscal deficit; and yet finance capital which vigorously opposes a fiscal deficit is perfectly willing to accept the sale of public sector assets as a means of closing it, i.e. as being on a par with taxation.

Put differently, there is a distinction in economics between “flows” and “stocks”. A fiscal deficit which is the difference between the government’s income (a “flow”) and expenditure (another “flow”) is itself a “flow” item; it can be closed through some “flow” adjustment, either larger tax revenue (a “flow”) or reduced “flow” of expenditure. On the other hand the sale of public sector assets refers to a “stock” transaction, involving a property transfer and hence balance sheet adjustments all around, which does not impinge on any “flows”, and therefore cannot possibly mitigate any ill-effects of a fiscal deficit. The fact that the IMF and other institutions of finance capital accept the sale of public sector assets as a supposedly-legitimate means of closing a fiscal deficit only shows their bad faith, the fact that their intellectual position is dictated not by any scientific considerations, but rather by an opportunistic desire to push the ideological agenda of privatization.

The intellectual dishonesty does not end there. When a private company buys public sector assets, it does so not with resources raised through skimping on its expenditure like some petty shop-keeper, but through borrowing or through foregoing the purchase of some other assets, all of which amount to balance sheet adjustments. Now, if the government has a fiscal deficit of Rs.100, then it would be borrowing this sum from, say, a bank to finance this deficit. But if it privatizes public sector assets to the same extent, then the private buyer of these assets would instead be borrowing Rs.100 from the bank to purchase these assets. To say that a fiscal deficit is “bad” for the economy but the sale of public sector assets is “okay”, amounts therefore to saying that expenditure financed by the government’s borrowing Rs.100 from the

bank is “bad” but the same expenditure financed by a private entity borrowing from the bank is “okay”! This is totally without any economic rationale whatsoever.

The matter can be looked at in yet another way. A fiscal deficit entails an increase in government debt; it is financed by selling IOUs by the government. Privatization of public sector assets entails selling government equity to private entities. To say that privatization is harmless but a fiscal deficit is not, amounts therefore to saying that selling government equity is harmless while selling government bonds (IOUs) is not, which again is totally without any justification, a mere ideological ploy to effect privatization.

The public sector was set up as a bulwark against the hegemony of metropolitan capital. It was a part of the agenda of unshackling the economy from imperialist domination. Under the neo-liberal dispensation of course governments go wooing metropolitan capital; nonetheless the public sector can still play a role by way of putting a limit to the extent to which metropolitan capital and the domestic corporate-financial oligarchy utilize their monopoly position to fleece the country. A government concerned with the interests of the nation, even when it gets caught in the web of neo-liberalism, would nurture the public sector to defend national interests against the depredations of foreign and domestic monopoly capital; but not so our Hindutva votaries who denounce all their critics as “anti-national” but hold dear the interests of precisely these monopolists as against the nation. They have no compunctions about dismantling the public sector built up with such effort in the teeth of fierce opposition from imperialism.

The modus operandi of neo-liberal fiscal policy is clear from all this. Neo-liberalism makes fiscal policy “pro-cyclical” rather than “anti-cyclical”. Revenues drop when the economy experiences a downturn. And to maintain its expenditure, the central government can neither tax capitalists (even though doing so would not hurt post-tax profits one iota compared to what it would otherwise have been if government expenditure had been cut), nor enlarge the fiscal deficit; it resorts to squeezing the states, with dangerous consequences for federalism, and to privatizing the public sector which makes the nation further vulnerable to the depredations of foreign and domestic monopoly capital.

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