Budget 2017-18: Blinded by neoliberalism*

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In an insipid speech that was repeatedly misread, Finance Minister Arun Jaitley presented on 1 February the contours of a budget that was shockingly short of substance. It left disappointed those who expected that policies to compensate sections hurt by the demonetisation experiment would be included and those who were looking for some measures to counter the demand slump afflicting the economy that had been aggravated by the demonetisation. It also surprised those who thought that the budget would be forced to expand aggregate expenditure and social spending to win voter support in the elections to the five assembly elections that were to follow.

In recent years the constraint on the adoption of such measures was a combination of the government's unwillingness to increase taxes imposed on the better off and deviate from its path of "fiscal consolidation", which involved deficit spending financed by borrowing. The inevitable casualty was aggregate expenditure relative to GDP. But this budget many argued would be different. There were too many reasons why spending had to increase. And, since tax rates could not be raised because in the wake of the disruption caused by demonetisation, the self-imposed adherence to stringent fiscal deficit targets had to give.

One reason why this was feasible was that, while the disruption caused by demonetisation had depressed private investment, it had hugely increased deposits with banks, since the old notes had to be handed over to the banking system and there were not enough new notes to replace them in circulation. Banks flush with funds were now willing to lend cheap to the government, which could borrow and spend to both make up for the shortfall in private consumption and investment spending as well as kickstart the economy. Since government debt-financed spending would amount to a draft on the unutilised savings of the private sector, it would increase aggregate demand, improve capacity utilisation and raise production in the economy, with no inflationary consequences.

So it is indeed surprising that rather than borrow at low interest rates to finance a proactive fiscal policy the government has adhered to its version of irrational reform and kept the fiscal deficit pegged at 3.2 per cent of GDP in a recessionary environment. This is the revised estimate (RE) for 2016-17, though those estimates are less reliable than normal since they are projections based on less information in a budget brought forward by a month. So more important is the claim that the deficit would be restricted to 3.2 per cent in 2017-18 as well, just one fifth of one percentage point higher than the governments medium term fiscal deficit target.

The principal message sent out by Budget 2017-18 was that "fiscal conservatism" was the Modi government's central objective and that its economic programme, if any, was some distorted notion of "reform". The components defining that notion of "reform" were experiments such as (i) demonetisation, the Goods and Services Tax and the promotion of digitisation to create a "less cash economy"; (iii) an open door to foreign capital, especially financial capital; and (iv) accelerated privatisation.

The implicit argument of the government was that measures such as these would be enough to address the sluggishness in the economy. In his Budget Speech the Finance

Minister argued that the government's optimistic projection of a "pick up in our economy is premised upon our policy and determination to continue with economic reforms; increase in public investment in infrastructure and development projects; and export growth in the context of the expected rebound in world economy." He added that "the surplus liquidity in the banking system, created by demonetisation, will lower borrowing costs and increase the access to credit," which "will boost economic activity, with multiplier effects." So the expectation is that borrowing opportunity created be demonetisation would be exploited by the private sector and not the government.

Among the stimuli that are expected to drive the Indian economy's growth, the reference to global recovery and a positive fall-out for Indian export growth is, if serious, little more than wishful thinking as even a cursory examination of the evidence would show. And the promise of substantial investment in public infrastructure is difficult to swallow. The Finance Minister claimed in his budget that India would spend Rs. 3,96,135 crore on infrastructure in 2017-18. However, not all of this would be backed with support from the budget. Thus, for example, the Railways, the budget for which was integrated into the general budget last year, is to see an increase in capital expenditure to Rs. 1,31,000 crore (from Rs. 1,21,000 crore last year). But budgetary support for 2017-18 for capital expenditure on the railways is placed at Rs. 55,000 crore. So the presumption is that borrowing or disinvestment would finance the rest. But since the railway budget has been integrated into the overall budget, borrowing would amount to central borrowing which has a ceiling. These aspects notwithstanding, even if the Rs. 55,000 crore projected for budgetary support is actually provided, the allocation is significant if actually realised (a likelihood to be discounted based on past experience). So is the allocation for roads and highways which is slated to increase from Rs. 53,343 crore in the revised estimates (RE) for 2016-17 to a budgeted Rs, 64,771 crore in 2017-18.

The problem is that these increases, even if they materialise, would, given the overall expenditure reduction visible in the figures, only amount to a reallocation of expenditures rather than any actual expansion in expenditure aimed at stimulating the economy. Implicit in the bugdet's numbers and arithmetic is a reduction in the ratio of the centre's expenditure to GDP from 15.8 per cent in 2015-16, to 13.3 per cent in 2016-17 and an even lower projection of 12.6 per cent in 2017-18. It is in the context of this overall contraction in expenditure that the only reference to spending in the Finance Minister's growth strategy reflected in the quote above, namely, an increase in public expenditure on infrastructure and development needs to be seen. That increase must be based on a diversion of funds from non-infrastructural capital expenditures and from discretionary revenue expenditures such as on health, education and rural development.

Even the realisation of the reduced level of expenditures projected in the budget is based on two assumptions, given the decision to peg the fiscal deficit at 3.2 per cent of GDP. First that the tax-to-GDP ratio that had fallen from 12.8 per cent in 2015-16 to 11.2 per cent in 2016-17, would remain at that level despite the adverse effects on tax collections of demonetisation and the small concessions given to personal income tax payers in the lower tax brackets and to small and medium enterprises. For reasons unexplained, income tax receipts are expected to remain buoyant and are projected to grow by 25 per cent next fiscal as compared with an estimated 23 per cent this fiscal.

Second, it is assumed that the government would be far more successful in its privatisation drive than it has been ever. Miscellaneous Capital Receipts (deriving largely from disinvestment and strategic sales of public sector equity), which are optimistically estimated at Rs.45,500 crore for 2016-17 (though actual receipts till end December were only Rs.23,529 crore), are projected at a huge Rs.72,500 crore for 2017-18.

Since these optimistic projections are unlikely to be realised, the contraction in aggregate expenditure is likely to be higher. Especially because the Finance Minister has made a virtue of keeping the fiscal deficit to GDP ratio to 3.2 per cent even when demands on him to enhance expenditure were substantial. He has not even given himself the "luxury" of exploiting the 0.5 of percentage point increase in the fiscal deficit to GDP ratio, relative to the previously set target of 3.0 per cent, that the official committee to review the ceilings recommended by Fiscal Responsibility and Budget Management programme had recommended. He has only taken the liberty to keep it at the 3.2 per cent he claims he has achieved in 2016-17.

One implication of this irrational adherence to the ideology of fiscal consolidation above all else is that growth to the extent that it occurs becomes dependent on debt. In fact, off-budget measures to increase availability of credit to agriculture and industry, especially the former, are presented as budget initiatives aimed at stimulating growth. In addition, efforts to give the demonetisation disaster a veneer of rationality include the claim, quoted above, that the large increase in deposits of the demonetised notes with the banking system would increase credit at lower interest rates and provide a stimulus for private spending.

This supply-side understanding that the increase in the credit-creating capacity of the banks would increase private lending and borrowing is completely without basis in a world where the constraint on investment is sluggish demand. Further, it ignores the much discussed fact that the banking sector is overburdened with non-performing assets, largely because of bad loans in the industrial and infrastructural sectors. As a result banks are not willing to lend and many of their clients cannot justify additional borrowing, leading to a slowing of credit growth. This in fact gave the government an opportunity. This not only means that debt-financed private investment and consumption, which had been the principal stimulus to growth during the high performance post-2003 period, can no more play that role. It also means that the principal financial measure being resorted to by the state, as a substitute for a proactive fiscal policy, has been blunted.

As a result, all that this government has is its unfounded belief that mere "reform" in the form of the demonetisation, digitalisation and the GST would deliver growth rather than recession. The emphasis on that role for "reform" is suggestive of the bankruptcy of the government's economic policy. Unfortunately that bankruptcy affects not just GDP growth but also a host of social sector expenditures that despite their deficiencies have important implications for the livelihoods, standards of living and welfare of India's poor and deprived.

Such faith in the efficacy of "reform", as argued earlier, amounts to adherence to wrong arguments that see growth as being constrained from the supply side. In fact, some of these like the enforced digitalisation of transactions amount to an engineered redistribution of income from the rest of the economy to the financial technology firms that facilitate such transactions for a fee. Inasmuch as the consumption out of the incomes of transacting agents is higher than the consumption out of surpluses accruing to the ‘fintech’ firms, this would only worsen the shortfall in demand that has been driving the economy to slower growth and recession.

Having chosen to adhere to this version of a counterproductive neoliberal agenda the NDA government had earlier in its tenure sought to divert attention through a range of “new policies”, including poorly planned programmes to clean the Ganga or the nation. Those, however, were policies that were harmless in terms of the collateral effects they had. But if showmanship and hype are to replace well thought out policy, newer policy innovations have to be dreamt up. Demonetisation and digitalisation (or the shift to a less cash economy) are two such. But they, unlike those that preceded them, have inflicted and continue to inflict immense collateral damage. The budget ignores that damage, not just to claim that reform of that kind will return India to being the world’s fastest growing economy, but also to avoid countering the recession that results from their pursuit and compensating those who were most severely hit by the demonetisation experiment.

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