Bad Economics, But Worse Politics

C.P. Chandrasekhar

Politics many argue is always in command. Not when it comes to the current version of the UPA government it appears. When Budget day 2013 arrived, the expectation was that the finance minister would hike expenditures, dole out some sops and dress up the budget to show that this is a government that is concerned about the common man who would step out to vote in a little more than a year from now. This is the last chance that the incumbent government had to make a focused show of such concern, which would have also been transmitted widely by a media obsessed with budgets. It seems however that this opportunity has been missed.

In a budget speech filled with irrelevant trivia, which belied its promise to be "simple, straight forward and reasonably short", Finance Minister Chidambaram has done much that would alienate voters and little that would win their support. As if the election did not matter and does not make a difference, the minister seems to have focused his attention on reining in the fiscal deficit. Having slashed expenditure during the final months of financial year 2012-13, to deliver on the revised fiscal deficit target of 5.2 per cent of GDP, Chidambaram has chosen to combine optimistic estimates of increases in receipts with substantially curtailed budgeted expenditures to deliver a 4.8 per cent fiscal deficit to GDP figure for 2013-14.

One casualty has been public expenditure. In a year (2013-14) when GDP is projected to grow by 13.4 per cent, total expenditure is expected to rise by only 11.7 per cent budget-to-budget. This implies a lower expenditure to GDP ratio and a reduced fiscal stimulus. As a result, even so-called "flagship" schemes of the UPA have not been favoured with larger allocations. Consider, for example, the National Rural Employment Guarantee Scheme, which is one of the few large programmes for the poor that UPA has launched, even if half-heartedly. A major push was expected on this front, at least with the election in sight even if not out of a desire to deliver the immense social good implicit in such a scheme. But allocations for the scheme are budgeted at Rs. 33,000 crore in 2013-14, which is the same as was budgeted in 2012-13 and marginally above the Rs. 29,387 crore actually spent this year.

In addition, expenditure reduction is being realised largely through curbs on or cuts in subsidies. Despite the promises made in the discussion on the Food Security Bill, the Food Subsidy is projected at just Rs. 90,000 crore in the coming year as compared to the Rs. 85,000 crore spent this year. Much of that increase in outlay would be absorbed by the likely increases in prices, even if the latter are driven only by increases in the minimum support prices. No major expansion of the coverage of those benefiting from the food distribution system and increase in the quantum of support provided is obviously envisaged. The fertiliser subsidy at Rs. 65,971.50 crore in 2013-14 is also almost exactly equal to the Rs. 65,974.1 spent in 2011-12. So farmers, who are suffering because of the growing non-viability of crop production, are not being given any support either. And, the expected decline in aggregate subsides is expected to be ensured by a fall in the petroleum subsidy from Rs. 96,880 crore to Rs. 65,000 crore. In the event, aggregate subsidies are expected to fall by more than 10 per cent in 2013-14 when compared with the revised expenditure estimate for 2012-13.

The risk the finance minister is taking here should be obvious. Since petroleum products are near-universal intermediates, increases in their prices are bound to feed into costs and drive the general price level much higher through many routes. In sum, the budget does not provide for any fiscal stimulus to reverse the growth slow down, but would indeed contribute to inflation. The stagflation that India is experiencing is likely to intensify, and there is little in the budget for those who would be hit most. These features of the budget cannot but be politically damaging.

It was not that the finance minister had no option. “The purpose of a Budget – and the job of a Finance Minister”, he had declared in his speech, “is to create the economic space and find the resources to achieve the socio economic objectives.” Given the growth slow down reversing that was one immediate objective. In fact, Chidambaram was of the view that India needs to “unhesitatingly embrace growth as the highest goal”. That required an expansion in expenditure, which needed to be financed in ways that took account of inflation and India’s ominously widening current account deficit. The requirement, therefore, was a large dose of additional resource mobilisation through taxation. Fortunately, additional taxation was not just needed, but also possible. As the finance minister noted, at around 10 per cent of GDP, the tax to GDP ratio was “one of the lowest for any large developing country” and well below the 2007-08 peak of 11.9 per cent. So ‘reclaiming that peak’ was an obvious short-term objective.

However, Chidambaram does not seem to have stretched himself to do that. In terms of taxation, the only noteworthy initiative was the imposition of a 10 per cent surcharge on individuals and corporations with taxable incomes exceeding Rs. 1 crore. Given the large number of concessions and exemptions available, the number of tax-paying entities falling in this range is small. The minister himself provides a figure of a paltry 42,800 individuals who qualify. They were, thus far, being taxed at 30.90 per cent on their taxable incomes in excess of Rs. 10,00,000. Now, they would pay the new marginal rate of just 33.99 per cent only on that part of their income that exceeds more than 10 times this sum. The effect on revenues cannot be substantial. Not surprisingly, despite the finance minister’s optimistic projections of tax buoyancy, the tax to GDP ratio is expected to rise by just half a percentage point in 2013-14. The task of finding resources has not been pursued seriously.

To partially conceal this failure, optimistic projections of future tax receipts have been been made with tax revenues budgeted to rise by 19 per cent relative to revised estimates for the previous year. This is based on an estimated 17 per cent increase in corporate taxes, 20 per cent increase in income taxes and 36 per cent in service taxes. Keeping in mind that even the proposed increase in taxes on a small group of high income individuals and corporates has been restricted to a surcharge rather than an increase in rates, and that growth is unlikely to be strong next year as well, many would see these as unduly optimistic.

To this the finance minister has added on a bonanza in terms of “miscellaneous capital’, which refers to receipts from disinvestment and measures like the sale of spectrum. Such receipts are projected at Rs. 55,814 crore in 2013-14, as compared to a revised figure of Rs. 24,000 crore in 2012-13, a budgeted figure for last year of Rs.30,000 crore and an actual for 2011-12 of Rs. 18,088 crore. The rather precise figure for 2013-14 may suggest that this is a valid projection. But the state of the markets and the recent experience with spectrum sale give no cause for such optimism. The finance minister has just presumed that he has a deep till to dip into because he has the nation's assets to sell. For this to be even partially true, huge amounts of profitable public sector assets would have to be sold at throwaway prices to attract so-called "investors". Indian and foreign capital may look forward to that, but it makes no economic sense and would only worsen the fiscal crisis of the government in the long run.

The play with numbers on receipts was to be expected. But what is surprising is that this has not helped the finance minister deliver the expenditure increases expected in the last full budget presented by this government. As noted, even after incorporating these uncertain receipts, the budget has had to rein in expenditures to meet its deficit target.

Put together, these indications from the budget suggest that the finance minister had either not given thought to or has ignored the tasks that circumstances had set for him. All he managed to do was juggle his numbers to show off a lower fiscal deficit of 4.8 per cent in 2013-14. That will please no one, except a few financial players who abhor deficits on the grounds that they are inflationary and give government an excessively proactive role. However, there are a considerable number of potential voters who would resent being harmed by the effect that the budget would have on livelihoods and real earnings. This being the last full budget of UPA II before the next general elections, effective measures aimed at showing concern for those who are chronically poor and distressed were a necessity. Yet the finance minister failed to support his party with the expected measures and to accomplish the tasks he had implicitly set himself.

The budget speech seems to provide one hint of what could be influencing the government's inexplicable policy drift. The finance minister has explained why the current account deficit (CAD) is a cause for worry as follows: "The CAD continues to be high mainly because of our excessive dependence on oil imports, the high volume of coal imports, our passion for gold, and the slow down in exports. This year, and perhaps next year too, we have to find over USD 75 billion to finance the CAD. There are only three ways before us: FDI, FII or External Commercial Borrowing (ECB). That is why I have been at pains to state over and over again that India, at the present juncture, does not have the choice between welcoming and spurning foreign investment. If I may be frank, foreign investment is an imperative. What we can do is to encourage foreign investment that is consistent with our economic objectives."

It is known that besides the World Bank and the IMF, private foreign capital too disapproves of higher-than-target fiscal deficits. So the finance minister may be operating on the presumption or may have received a signal that if foreign capital inflows to finance the CAD have to be found, the fiscal deficit has to be controlled. While talk about the downgrading of India by the credit rating agencies suggests that this may be the case, this argument does not explain why taxation cannot be resorted to in order to both curb the deficit and finance additional expenditures.

Nor does it make clear how the problem of a widening current account deficit is to be resolved. In fact the government does not seem to be focused on addressing the high CAD. One item that has contributed to the widening trade and current account deficits is the import of gold. Increasing further the duty on gold imports was the way to go, since there is no justification whatsoever for a small minority to use the nation's foreign exchange resources to purchase the yellow metal whether as ornament or investment. Instead the finance minister has chosen to send out a signal encouraging the import of gold by raising the duty-free limit for import of jewellery through the baggage route.

The problem thus seems to lie elsewhere. Developments prior to the budget suggest that an unthinking adherence to a kind of ideology has driven the finance minister and his government to failure. Measures like the deregulation of petro-product pricing, the increasing resort to cost-plus pricing of power mediated by a tariff authority, and the introduction of a dynamic fuel price adjustment component into setting of freight rates of the railways had made clear that the focus of policy was on fiscal adjustment through a reduction in expenditures led by a cut in subsidies. This thrust was only corroborated by the Economic Survey, which stated that while the reason for India's growth recovery after the global crisis was the stimulus provided by the government, the downturn was the result of a tight monetary policy adopted in response to the inflationary environment the stimulus created. Since higher taxation is seen as disincentivising savings and investment and deficit spending as aggravating inflation, the argument possibly is that the onus of triggering another recovery is now on the central bank, which needs to shift to an easy monetary policy. But that would still leave problems like inflation and the current account deficit unresolved.

The adherence to an ideology that makes no economic or political sense also reflects the state of the Congress party. The separation between party control and management of government and between electioneering to garner votes and actual policy making has led to a situation where what is seen as good for governance by those in state does not seem good for the party when it comes to winning power. It is still unclear which way the next election would go. But it does appear that those in government have forgotten that they owe their position to the votes garnered at election time.

* This article was originally published in Frontline dated Mar. 09-22, 2013.