‘COMMENTARAO’ IN “THE TELEGRAPH” OF DECEMBER 9 2013

“IMPROVING THE ECONOMY
- Politicians must observe how subsidies affect deficit” by S L Rao

The years 2009 to 2011 saw India register growth of gross domestic product by 8.4%. This year it may be 4.8% and government talks of it climbing to 5% next year. This may be better than most other countries. However the comparison must be with our past record, not with other and that too, developed economies. Since 2008 the powerful economies of Europe and USA have been caught in major failures in their financial markets. Their growth is only now appearing to recover.

The Congress has run the central government for ten years and the BJP before for almost six. Could either have done better today? Coalition governments and a weak global economy imposed some constraints. But all politicians are reluctant to raise administered prices (petroleum products, food grains, and health and education services). Poorly identified beneficiaries in social schemes (education, employment, food security, livelihoods, health) have led to rising social expenditures. They have further added to deficits. No politician will happily reduce or withdraw them. Economic growth, with better tax revenues, had kept deficits due to rising expenditures low. The economic slowdown without cutting expenditures, has led to higher deficits. These have led to inflation, declining savings and investment, poor industrial and employment growth.

India had an unannounced ‘stimulus’ through public investment during 07-08 to 09-10, (% to GDP 8.9, 9.4, and 9.2), falling thereafter. But in the same period, private investment was in decline. The public investment was in infrastructure, but implementation has been tardy due to slow government clearances. Consumption expenditures also rose as government added heavy expenditures on social schemes. Inflation rose, hence interest rates, further slowing the economy.

The global economy did have adverse effects as fund inflows and exports slowed. Oil prices remained high. With oil and gas imports at almost 80% of our imports, balance of payments deficit rose and external value of the Rupee fell. However, the important reasons for economy declining were our domestic policies, not declining global economy. In contrast, China did not have such a decline as we did.

Over the last three years, we have had record fiscal deficits, declining tax revenues as percentage of GDP, high balance of payments deficits, declining savings and investments, erratic overseas fund flows, poor industrial growth, enormous delays especially in infrastructure projects, consequent pressure on bank finances and performances. High non-performing borrowers, high interest rates, and persistent high inflation especially in food products characterized the economy. Urban households have suffered due to poor employment growth and rising costs of housing, transportation and food. Urban consumption expenditures have fallen, adversely affecting industry. However rural incomes have been rising due to rising crop support prices, good rains, repeated write-offs of bank loans to farmers, substantial handouts under the employment guarantee scheme and other schemes. Apparent rural prosperity today has made industry try to develop rural sales. Rural prosperity is based on misguided policies (of subsidies-electricity, water, fertilizers, and loan write-offs) and may be unsustaiable

The combined fiscal deficit of central and state governments which was 4.04 % in 2007-8 went up in subsequent years to 8.44%, 9.39 and 7.72%. The Finance Minister is targeting 4.8 %, expected to be much exceeded even with postponing payments of bills due this year to next year. The deficits were primarily due to subsidies (mainly on petrol, diesel, kerosene and gas), and unbridled growth in social welfare expenditures. The highest deficit was in the same year as the start of the global economic crisis when India showed GDP growth of 8.4%. ‘Stimulus’ added to incomes, expenditures and inflation. It did not add much to outputs. The deficits on the current account in the balance of

payments also spurted from 2.6% of GDP to between 3 and 4 % each year. The rupee to dollar declined in ten months from Rs 43 to Rs 67.

Over half of revenue receipts of the central government are spent on subsidies, (around 5% of GDP), in which fuel subsidies are estimated at 2.9%. Then there are the social schemes like the national employment guarantee programme, food security, national rural and urban health mission, etc. The MNREGA alone had spent Rs38034 crores in 2011-12 and in 2012-13 Rs 29433 crores. Repeated studies in different parts of the country have shown that a significant part of these expenditures are diverted to the undeserving. So it is with subsidies. For example, 40 % of subsidized kerosene is estimated to go for adulteration of diesel. Similarly, much food for the poor ends up in the markets.

Balance of payments deficit is caused by global economic decline and high crude oil prices. But our policies are also responsible. Thus, we surrendered garment to Sri Lanka and Bangladesh. Our labour laws do not encourage factories to have 20000 or so workers as those countries do. Our labour laws make labour intensive product exports uncompetitive. Iron ore exports are down due to bans caused by scams. Rupee decline led to massive gold imports.

Investment in infrastructure as a % of GDP has been rising and rose sharply from 2008. It was 5.71% in 2006-7. 7.1`8% in 2008-09, 7.51% in 2010-11 and 8.37% in 2011-12. But implementation has lagged due to delayed government, coal supply setbacks, rise in imported coal prices, unavailable gas, and delays in government clearances. With around 80% as bank financing, banks are now sitting on over Rs 7 lakh crores of loans to projects whose implementation is stuck. Banks are in poor financial shape as a result. Now the PMO has taken charge of expediting clearances and is said to have cleared over half already.

Tax revenues to GDP, already low with comparable countries, showed decline from 18.79 % in 2009-10, and 17.52 and 18.01 % in the next two years. Non-tax revenues also are not growing as expected. The fiscal deficit went up and has triggered high inflation especially in food products for the last two years. Subsidies have been considerably reduced in the last year, with government at last moving to market based pricing for oil products. Petrol prices are now linked to imported crude prices. Diesel prices are being raised gradually. However, fertilizer subsidies are rising. Social scheme expenditures are also

seeing tightening. It does not appear that there is adequate reduction in these expenditures to truly reduce the deficit. The usual subterfuges like postponing to next year, payment of substantial bills to of current year, may show a lower actual deficit figure this year!

How should a prudent Indian political party. BJP or Congress, manage the economy? All Indian politicians are populists. They rightly spend on the poor on subsidies and supports. However they must always keep close watch on revenues and the effect of the expenditures on the deficit. Growth is a valuable accompaniment to populism since tax revenues go up with growth. All import costs of products with high import content (petroleum and other oil products, fertilizers, etc), should be covered in their prices. Bureaucratic and administrative implementation procedures should be tightened. Individual accountability of all bureaucrats must be ensured. Penalties for stealing from such schemes must be severe. Targeting of beneficiaries and identifying them, with a direct benefit transfer must be ensured. Thousands of micro bank branches must be opened. Government accounting must shift from cash to accrual to prevent budget subterfuges. The government must get out of managing public sector enterprises including electricity and make them independent. The GST (goods and services tax) must be expedited to make India a single market. Incentives for savings and investment would help.

Most of these are not political decisions but good governance. Both BJP and Congress must take and implement them. (1288)