BUDGET (2000-01)

DRIFTING TOWARDS THE CLIFF ?

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By
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Mumbai, March 2000.

BUDGET *2000-01*: DRIFTING TOWARDS THE CLIFF?

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I was quite disappointed, a little angry and frankly surprised [1] about the Budget for 2000-2001. I was pleased to see some deft moves. Yet the overall feeling was that as critical issues are needlessly brushed under the carpet the **fisc** drifts towards the cliff. The budget proposals contain quite a few specific **moves**- some remarkably positive, situation is deeply others not so. I comment only on a few of them in Section I. An apparent paradox at present is that while the fiscal is deeply disturbing, economic outlook broadly gives scope for relief. Section II tries to explore this paradox and some likely repercussions. Critical analysis is not enough and only harsh options are now available. In my view a savage control on Government expenditure and that alone, can still save the situation for us. In the final Section III, I therefore outline such a seven-point minimum plan. There is no chance of any of it being found politically acceptable. Alas, there is no escape from it either.

Some of the boxes should provide material for light and meaningful relief from this otherwise dull and depressing subject. I freely used a few of these stories during my many post-budget speeches.

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[1] Last Day Change?

*I read the ' Fiscal **Policy'** chapter of the Economic **Survey from** my computer in the late **afternoon** of Monday February 28. The **fiscal alarm** signals wen once mom **clear**. Later in the evening, I met a **journalist** friend **while** I **was** having a walk at the **Worli Sea** face. " Am you **preparing yourself** for a **harsh** Budget7 " he **asked**. I said " **Yes.** Them is no escape, now that even the Economic Survey **has** given the same message.' He **replied,** "Don't **prepare. Drastic changes have** been made in the last one **day,** to make it a very soft budget. On the **Mamata lines.** You will see **tomorrow."** Puzzled ,I asked " But can it be changed at **this stage?** And why?" "Oh, State elections, **Madhya** Pradesh, **Chauthala...** Don' t ask me: and he **went** away.*

*I do not know if then, **was** any truth in what he **said** or it was just **kite-flying.** But I do get a nagging feeling that if them **were** any truth in it, then this is the sort of Budget we **would** have being **served** with.*

I
SOME BUDGET MOVES : A MIXED BAG

In the course of his speech presenting the Budget for 2000-01, the Finance Minister has outlined several specific moves affecting industry, individuals and the Indian economy. Some are very creditable. Some more are not equally so.

(A) Very Creditable.

(1) Last tear the F.M. abolished his own discretionary power to grant ad hoc exemptions from customs and excise. He was deservedly complimented on this courageous move. Now he reports that this self-denying rule has saved about Rs. 500cr of revenue. Bravo, and congratulations once more.

So far, revenue of this order was obviously being lost year after year. Much of what was a loss to Government was an unscrupulous gain to some; namely those who benefited from these exemptions and those who had the power to give the ad hoc exemptions.

Incidentally, this self-denial did not apply to 'goods of strategic nature or for charitable purposes.' I will be very interested if the F.M. could publish a list of ad hoc exemptions granted under these two categories with the names of parties concerned and the revenue loss expected.

(2) Tax exemption to exports is to be phased out in five years. Not a bad idea, really. Earlier exports of goods were receiving the exemptions; but incomes earned in foreign exchange from export of services etc (Sec 80-O) were taxable. That was a distortion. In due course, exporters will get used to it. However, Government should not be finicky about the Rupee.

(3) The FIIs will be allowed to invest in Indian companies up to **40%** of equity now, against 30% so far. Some commentators argue that this increase is theoretical, because barely half a dozen companies have reached the 30% level. I think the increase does give a positive policy signal, and that is valuable.

(4) Capital gains invested in buying a house were exempt from tax only for one's first house. Now the exemption is extended even for the purchase of a second house. The earlier restriction was again a distortion, perhaps one of the many relics of our 'socialist' nightmare. Good riddance. This move should also give a further boost to the housing sector.

(5) The post-QR import duties are mostly at the highest slab. Understandable; and also a sop to the Swadeshi lobby.

(6) From July 1, all statutory excise records are to be dispensed with. Excise department will rely on the manufacturers' records. A good move; and a clever one. I take it that most manufacturers will welcome this as a major simplification. However, some will be nervous at the idea of having to display their 'factory records.' Government need not shed tears for them.

(B) Not Very Creditable

(1) Deletion of 54EA and 54EB provisions in the name of 'more focussed incentive' is not justified. Of late, several instruments had become available for claiming capital gains tax exemption. There was competition and the investors had a reasonable choice. Now the public sector NABARD and NHAI will have a monopoly. This will be rightly interpreted as a clumsy way of forcibly canalising capital gains funds to the public sector. This is a retrograde step particularly when the Government is singing the virtues of promoting competition, and a full-fledged committee is working on this issue.

(2) The increase in the Dividends tax to 22% is difficult to justify either. When Mr Chidambararn introduced the dividend tax, he was in a sense lucky. The corporate sector was doing very well. It largely absorbed the tax itself. The investor shareholders did not feel the pinch. On the contrary, they received practically the same dividends free of tax in their hand. Not so this year.

The increase is particularly harmful to the extent that it applies to the income-oriented mutual funds. The investors in this category are mostly risk-shy middle class citizens. The same F.M. cajoled investors to this avenue only last year. Now he himself in a way traps them, after insisting that 'stability' was a pillar of his tax policy! The sooner he rescinds this proposal, the better it will be to establish credibility about his intentions.

(3) Overall, his proposals will hit hard those individuals that largely depend for their incomes on returns from their own savings: First, inflation in the coming year will be higher than now. (5.5%, up from 3%). Secondly, interest rates on their bank deposits, on PPF or other fixed interest instruments may, if anything, be reduced. On top, their returns from such mutual fund investments will also be reduced. Was this the intention of the Finance Minister?

(4). The willingness of Government to reduce its equity holding in suitable public sector banks is touching. However, the move is conceptually weak and is unlikely to be of much practical significance. The F.M. insists that the public sector character of the banks would be retained. This very character translates itself into investigating agencies, parliamentary committees, NPAs, interference, backseat driving and all the rest of it, and plays havoc with the banks' bottom lines. In addition, he assures that the workers' interests will be protected. (Read: Even if 2000 employees can do the work more efficiently than what the present 20,000 are doing, not one of them will be touched. Actually, each one of them would continue to be given lavish salaries and goodies.) Which members of the public would like to buy these shares, I wonder.[2] Chances are that most of them would have to be nursed by financial and other institutions suffering from a similar ' public sector character.'

(5) The Finance Minister has repeatedly told us recently that the fiscal situation is grim. Other plain economists have been shouting about this for the last three or four years, but that is another matter. Nevertheless, the EM. chose to spend largely the first one hour of his 100 minute budget speech outlining numerous schemes and plans that ***increase*** government expenditure or announcing the setting up of new committees, task forces, departments and the like. He knew fully well that barely fifteen paise in every rupee of government expenditure reach the targeted beneficiaries. I am not impressed.

***[2]PSU** Banks*
*A small gathering was discussing the government's willingness to **reduce** its holding up to 33 % so that selected PSU banks could raise capital. **A PSU** bank enthusiast said he liked the proposal . He would like his bank to issue shares. " We can issue them at par so that there is a roaring public response," he said. " At par? That is a hefty **premium1"** his friend eacted.*

(6) I am even less impressed with the F.M.'s proposals regarding privatisation. He hopes to get Rs. 10,000 crores from this source; but in advance of any receipts, he has already pre-empted practically the 'entire receipts' for 'meeting expenditure in social sectors and restructuring of the PSUs. '

In the first place, experience suggests that there would be a major shortfall on this account. Secondly,' social sector' being everybody's favourite, the amount s would be spent in any case, with the result that the fiscal deficit would actually go up and not down. Finally, while the total amount should have been earmarked for the buy- back of some portion of the public debt, what we see is a promise of a buy- back of a trivial Rs. 1 000 crores.

Respectfully, I feel that in touting about with these figures regarding the retirement of debt, the EM. has shown scant respect to the intelligence of Indian citizens. Last year too, the same F.M. talked of downsizing[3] the government and announced the abolition of four secretary-level posts in support of his intentions! This, when he knew that, the size of the bureaucracy was going to increase; and increase it did by at least 81 000 employees during this year of 'downsizing.'[3]

Privatisation is a medicine. We need large doses of it, and professionally administered. However, what the F.M. plans to give is a wrong medicine with a false label of 'Privatisation.' This can only aggravate the malady of our grim fiscal situation.

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[3] DOWNSIZING:
*How can we downsize or right **size** if we do not know even the current **size?** Government said that the total size of the bureaucracy was over **39lakhs.** Now they say, no, it was **actually** about 37.5 **lakhs!** A **difference** of more than **150,000!***
*In the old joint **family** days, womenfolk **at** home stitched children's clothes. So the ladies made a shirt for a little boy in the **family. Excitedly** he tried It on **in** the evening but found that the sleeves were too long. He **took** it to his elder sister end requested her to make them shorter **by** a couple of Inches or so.: 'Not nop ,dear. I am busy with schoolwork.' A little dlseppointed he approached his mother.: **How can you ask** this **now?** Can't you see I am In the **midst** of **cooking.?"** He then **went to his grand** mother. " Sorry, darling. I have not even started my evening Pooja yet. Don't waste your time. It is late already . **Go** to bed now.' A little heart broken, he went to bed. Next morning , his mother woke him up and told him that she had shortened the sleeves as he wanted. He was happy and rushed to try the **shirt** on. To his surprise, he **found** that the sleeves had all but vanished! Grandma said " I shortened them by two inches as **soon** I finished my Pooja." The sister **said "I** did it too, when I **finished** my school work." Mother **said** " I woke up yet early to to shorten them so that he can use the shirt at school today"...*

II

THE BUDGET FUMBLES, THE ECONOMY GROWS.

The overall fiscal picture presented by the latest Budget is very disturbing indeed and has deteriorated badly during the year. There are three villains of the piece: expenditure, deficit and debt. They are all neighbours and live on the one-way Bankruptcy Street.

The Budget has indulged in some 'creative accounting,' mainly with respect to small savings. After reworking the various figures to get an equal-to-equal and a more faithful picture and after squarely rounding many of the intricate numbers, I find that total government expenditure during the current year is likely to be Rs. 3, 03,738 crores. This means an increase of 17.5 percent within one year. Next year, it will increase by at least another' 11.5 percent. Revenue from all sources adds up to much less. To bridge this deficit (known as the fiscal deficit), the Government will borrow a massive Rs 1,09,000 crores this year and another Rs 1,12, 000 crores next year.

It must be emphasized that these borrowing figures, shown as liabilities of the Government, are ***net*** figures. For example, in 1999-00, Government' s aggregate liabilities will total to about Rs. 2,24, 000 crores. Every year some part of Government's previous borrowings become due for repayment. In 1999-00, Rs 1,15, 000 crores will be the instalments that are thus due for repayment. These will be paid out and the Government would to be left with the balance, viz. Rs 1,09, 000 crores as the net new loans, available to finance its spending spree. Of course, the Government must also pay the interest due on all the outstanding loans to date. This interest burden is to be Rs 91,000 crores in 1999-00. The sum of instalments and the interest burden, together is called the ' total debt servicing', and is shown as such in the budget documents. In every sense, this is the first charge on any'income of the Government, just as it would be for an unfortunate family in simitar circumstances.

In 1991, we in India narrowly missed a brush with international default. The then continued fiscal mess was widely accepted as the root cause of it all. At that time, our fiscal deficit was about 7.7% of GDP. On a similar basis, our fiscal deficit this year will be about 7.5% of GDP. Next year it is' hoped' to be 6.8%.[Ignore the official figures of 5.6%and 5.1%]. In fact, the track record of this Finance Minister as to what he says he hopes (i.e.. what he budgets), and what actually transpires is not the best in the world. Some extrapolation of his record suggests that the comparable fiscal deficit could be around 9.45% of GDP next year. Not very comfortable.

Incidentally, the total outstanding liabilities of the Government will be Rs10, 30,444 crores as on March 31, 2000, and will rise to Rs. 11,79,493 crores one year later. In all the ten volumes of documents together known as the 'Budget Documents', I did not find any larger figure. Honestly, these astronomical figures are a bit beyond my comprehension! At a practical level, central government debt is well over Rs 10,000 per head, and is rising every year.

Then the debt trap: Total government receipts, - including taxes, non-taxes, everything-are to be Rs 1,95,000 crores this year. However, as was seen above, the total debt servicing itself is very high at Rs. 2,07,000 crores. Thus, the entire income of the Government is not enough even to service its debts. In other words, every single rupee that the Government spends on anything- on defence, on salaries, on buildings, on plans, on dams or on anything else- has to be from freshly borrowed funds. What else is this if not a debt trap? Government economists (in service) may coin some misleading definition to prove that we not yet there, but merely 'inching' towards it! I will not buy it.

While these fiscal indicators are all sounding alarm bells, paradoxically the overall economic outlook gives cause for some relief. I am inclined to broadly share official estimates in this respect: In the year 2000-01,the rates of real GDP growth as well as agricultural and industrial growth should exceed the current year's likely achievements, though not by a very big margin. It will also be another eventful year for the corporate sector. Regrettably, inflation will return and interest rates would not dip much further, Broadly, the whole situation seems to be much under control now as compared to 1991, though the Budget is in a similar mess. How come?

A part of the explanation lies in the fact that the economic outlook is no more a total prisoner of government's fiscal policies, as it used to be in the heyday of the license permit raj. There is now much more internal competition in most industries, largely because many are no more the preserves of the public sector. There are practically no big scarcities; there are in fact under-utilised capacities. Moreover imports are all the time waiting in the wings to rush in, the moment there is any smell of scarcities developing. Quite often, even if there are no scarcities, the foreign parties practice dumping and keep the Indian producers on tenterhooks. So scarcity- oriented high inflation will be less common.

Nevertheless, an enormous inflationary potential still exists due to (i) the government's high- interest, massive and unproductive borrowing programme, (ii) tax-based cost-push factors and (iii) infrastructure bottlenecks. In addition, and quite apart from inflation, the government's mismanaged fiscal show must one day hit the economy, and then hit it will hard. The situation does not deserve any complacency.

That is why, most western countries, where inflation is more or less claimed to be dead and where budgets are not in such disarray as they are in India, are still extremely worried about deficits and debt. The U.S. presents a refreshing example: In 1992, they had a budget deficit of $290billion, one of the largest in the world. In a remarkable turnaround, they achieved a budget surplus of $69 billion in 1998 and of $123billion in 1999. Yet,

the political temptations of spending away these surpluses in vote-catching expenditure were resisted. On the contrary, the surplus will be used to buy-back up to $30 billion of government debt this year. They are now talking about a debt-free U.S. by 2010 A.D. Explaining this, the U.S. Treasury secretary Mr L. Summers said in Mumbai recently that the U.S. tax-payers support the buy-back because they clearly see it as a tax-cut, which indeed any buy-back of debt is.

In contrast, we are merrily increasing our expenditure even if every rupee of it comes from borrowing. Expenditure is not reduced by merely talking about downsizing the government; nor by deciding to appoint an' Expenditure Reforms Commission' and then taking full 367 days to actually appoint it; [4] A harsh plan to effect cuts in expenditure, cuts that will bite and hurt, was expected. That was the road not taken.

'The Economist' of London is a well-read international newspaper. Rarely does it write its first editorial about India. But it did, on our latest Budget, and said "..The Plan announced on February 29th, was timid. Seasoned India-watchers will say it could have been worse: Yashwant Sinha, the finance minister has done nothing outright stupid. Nonetheless, measured against the twin tests of need and opportunity, he has let India down".. That is a harsh comment. We did not bargain for it. But then, we did not get the harsh Budget, though we bargained for it.

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[4] Quick Action :
Government knows that expenditure control is of critical importance. Yet, it takes full 367 days just to appoint a Committee. Nothing surprising really. That is ' public sector character'
Many years ago, the public sector was enjoying the commanding heights of the economy. There was of course no delegation. The Public Sector Enterprises Board had issued huge volumes of detailed Guidelines prescribing dos and don'ts for all sorts of possible situations that may arise in running the PSUs. One day a PSU factory caught fire. Only one fire extinguisher was installed as per the guidelines. That was clearly not enough. The General Manager hurriedly went through the guidelines but they were silent. Confused and in panic, he rang up the chief of the PSEB at Delhi. Luckily, he was in office. The G. M. asked for instructions. The chief was furious. " The factory is on fire and you are wasting time telephoning. Don't you have any sense of urgency? Do not waste a minute more. Go and immediately call for tenders for fire fighting equipments"

III
CURBING GOVERNMENT EXPENDITURE
A Seven Point Savage Plan

The root cause of India's Budget crisis is in impossibly high deficits. Deficits can be controlled only in two ways: (a) by raising revenue, and/or (b) by cutting expenditure. Harsh budgets come in two flavours: Budgets that would unravel either a savage plan for revenue generation or a savage plan for cutting expenditure, [or possibly both].

I remain convinced that, for various reasons, revenue generation is not the answer for us;[5] It does not work. In fact, it aggravates the malady. We must concentrate on curbing expenditure, and this is still within our capabilities. Therefore, if the F. M. had produced a budget with a savage revenue generation plan, I would not have liked it at all; but it would have certainly passed the test of being called a harsh budget. If on the other hand, the F. M. had produced in his Budget a plan for savage cuts in expenditure, I would have readily welcomed it. He produced neither.

I therefore, will take the liberty to outline my illustrative seven-point plan to control expenditure. It is not only harsh, it is 'savage'. Not one single element in it will be politically acceptable. However, if we want to avoid yet more ominous implications in future, there is no escape from it.

[5] Revenue Generation:

There are many reasons why resource generation is not an answer. In the first place, why we should go out our way to suggest ideas to Government as to how it can further empty our pockets?

One day a thief forced himself into a small secluded house where an old lady was living all by herself. She was scared and readily surrendered her bangles she was wearing. The thief started searching the house. In tears she pleaded;" I have given you the bangles. Please go away now. At least keep me my small cash in the lowest drawer of the table. " So the thief helped himself. The old lady implored, "You are so selfish. At least spare me my few silver utensils, which I have so carefully stored in the trunk below my bed" The thief smiled, packed them in his gunny bag with him and rushed to the kitchen. She was aghast. " No, don't go in, and for God's sake, don't touch at least the that tin box marked PAPAD. All my ornaments and pearls are there. If you take away those too, I will be literally a beggar". In a minute she was!

(1) Total government expenditure should be frozen. If the total expenditure is Rs. 303738 crores in 1999-00, so it shall be Rs. 303738 crores in 2000-01 too. This will apply to every Ministry and Agency. Thus, e.g., if the expenditure of the Ministry of Chemicals and Fertilisers is Rs. 9147 crores in 1999-00, it should be the same in 2000-01 too. Each Minister concerned should be delegated complete freedom to manage his Ministry's affairs within the overall ceiling. If he chooses to spend more on a particular activity, he will thus be obliged to first effect equivalent savings on some other activities. Some may wish to start more projects that are new and postpone existing ones; others the other way round. Some, to spend more on cars; others, more on travelling. Some, on employing more people; others on less. Some may want more office space, others may sell away some of the existing space. Etc.

(2) Borrowing and/or lending of resources among the various ministries should be permitted. If Minister A feels that from his allocation he can save say, Rs. 500 crores this year, he is welcome to lend this amount to his colleague Minister B, for say, one or two years, at a mutually agreed rate of interest. Similarly, Ministers can lend and borrow employees, office space and other resources. I visualise that large chunks of funds and employees will be made available under this dispensation.

(3) At present there a spending spree among ministries and departments in February and March every year. For, if the actual expenditure is less than budget grant, the grant for the next year is almost certain to be reduced proportionately. If it exceeds the grant, the ministry's hands are stronger in demanding a higher grant for the following year. Not only a carry-forward should be permitted, it should be well rewarded. If a ministry has a budget grant of say Rs 1000 crores for 2000-01 but manages within Rs. 900 crores, not only should the saved Rs 100 crores be added to its allocation in the following year, but the ministry should be given an extra 15% of the saved amount as a gesture of appreciation.

(4) Ministries should be free to ask surplus staff members to sit at home for say two years or so, with their full salary cheques being sent to them every month. There are at least four good reasons to propose this. First, it is well accepted that the total cost of an employee to the employer is much more than the salary paid. Many prosperous organisations work out these estimates to ensure that the extra return to them from every additional employee is well above this total cost. Secondly, as a necessary result of market-oriented structural reforms, several government activities have become largely superfluous. Thirdly, this not only works but also in fact gives striking results. Recently, a multinational company reportedly asked hundreds of workers in its Sewri factory to thus stay at home. It is also well known that when the employees working at some Octrai nakas in Mumbai went on strike, the octrai collections increased more than two-fold at the hands of substitute college students! Finally, there is evidence from other countries too that most of the workers sitting at home, even on full salary cheques, find other and better jobs, and do not report back after the stipulated period.

(5) When employees retire, the resulting vacancies should not be filled up, particularly when there are several posts of an identical designation. If there is only one single Cabinet Secretary, it is understandable that his post should be filled up when he retires. However, if there are say fifty undersecretaries and five were to retire, the remaining forty-five should have to manage the total workload. Here again the Minister concerned should be given the freedom not to fill up specific posts.

(6) After all these steps are taken on Day-1, a further exercise of zero-based budgeting should be forthwith initiated and implemented. Persons with a radical mind-set who are not bogged down by conventional wisdom should be requested to advise, with an assurance of implementation. There are dozens of government activities that have lost their relevance in the context of reforms. There is duplication all round. I

feel often sad to see so many talented and well-qualified Indians rusting in the bureaucracy. Some friends, with a more radical mindset, have argued with me e.g. that there is a strong case for privatising the Planning Commission and turn it into an independent think-tank; or that if Octrai collection can be privatised with conspicuous success, why not the income tax collection? The possibilities of zero base budgeting are immense. That perhaps explains why everybody talks of zero-based budgeting, but none will actually do anything about it.

(7) This much about the existing spread of the Government. Government should not take up any, repeat any, new activities of any size without the express approval of the Prime Minister; and unless they are of a strategic or sensitive nature, details about these should be publicised. The latest Economic Survey has underlined the fact, in the context of the success of the IT industry, (Information technology, not income tax please), that things move far better when the Government keeps itself out of them[6] and that many more success stories will be added if only, government would free those areas from its helping (!) hand.

Lord Keynes reportedly said," Man will do the rational thing, but only after trying all the irrational alternatives." Did he foresee the budgets of the Government of India? Are anymore irrational alternatives left?

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*[6] Budget and **Beauty***

*As I was watching on the **T.V.,the** Finance Minister reading Part A of **his** speech and disclosing various plans and programmes for which Government **will** offer its helping hand, I was holding my breath waiting for the following statement Luckily it did not figure **in** the speech;*

*"In the thick of tough world-wide competition, young Indian girls have **achieved** striking success in the beauty contests for three consecutive years. We are **proud** of them. Their success underlines India's great potential in this high profile area. In order to help tap this potential fully we will set up a 'Department of Beauty Contests: I am making an Initial allocation of **Rs** 50 crores for this purpose. More funds will be provided if needed."*

*[**'Luckily'** Indeed. Had it figured in his speech, not one **Indian beauty** could have ever made the **grade** for the **next** ten **years.]***

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