I. Current Economic Environment for Business

II. The Budget We Need

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CONTENTS

		Pages
1.	Current Economic Environment for Business	1-9
2.	The Budget We Need	10-17

I. Current Economic Environment for Business

Several parameters influence the current economic environment for doing business in India. If I were to write a 50-page book expressing my views on some of them, the following will be its executive summary:

I) Reforms

The question most often asked is: 'will reforms be reversed?'. The answer invariably heard is: 'No'.

I am afraid, there is a catch. For example, huge fiscal deficits were the root of our economic crisis in 1991. A sharp reduction in the deficits [in jargon: fiscal stabilisation] was thus the crux of the reforms process. We started well and the deficit was reduced from 8.4% of GDP to 6.00%. But then we gave away the discipline; and let the deficit balloon again to Rs.57,000 crore in 1993-94, (or 7.3%). For 1994-95 it will be close to Rs.65,000 crore. if not more. For 1995-96 pre-election compulsions will again let it expand. Is such a return to fiscal profligacy anything but a reversal of the reforms process?. For 1995-96, any budget estimate figure for fiscal deficit which exceeds 5% of GDP (or about Rs.53,000 crore) should be interpreted as a reversal of reforms to that extent.

The Finance Minister himself in his latest interview (published on January 20, 1995) has now said that the process of economic reform is 'almost irreversible'. Interesting.

(II) Inflation

The current year 1994-95 will witness an average WPI increase of 10% to 10.5%. There are three main factors responsible for the current phase of inflation. In order of importance, they are: (i) High fiscal deficits; (ii) Significant increases in a whole range of administered prices and (iii) Foreign capital inflows resulting in an increase in money supply.

As stated above, fiscal deficit is the key. Increase in administered prices are also largely linked to fiscal deficits. Action on both fronts is vital but is obviously considered politically impracticable. So policy makers are barking up the wrong tree and are devising policies to discourage or reduce capital inflows.

I reckon that there is usually a lag of roughly one year between the time government indulges in a high fiscal deficit and the time it is reflected in higher inflation. Thus, a high deficit in, say, year 4 will show up in high inflation in year 5; similarly, a low deficit in say, year 9 will result in low inflation in year 10. Thus the seeds of high inflation rate of about 10% for the year 1995-96 have already and firmly been sown in the high fiscal deficit of about Rs.65,000 crore for 1994-95.

(III) Budget

Ever since Mr. Seshan 'advised' the government to postpone the budget date until after the polling at State elections was all over, it was clear to me that this 'advice' would come extremely handy to politicians of all parties; and that – after a big song and dance (for public consumption) about government's prerogative

and all that – they will too willingly accept this advice. Most probably, the government will keep a safe distance of about ten days between the date that election results are known and the date of the Budget; and these intervening days will give sufficient time for the ruling party to study the implications of the election results and to tailor the Budget with a view to getting the best mileage at the forthcoming general elections. The week beginning March 20 seems to be an excellent choice. For once, the politicians did get the better of Mr. Seshan.

In view of this revised schedule, the likely direction of the Budget also seems to be clear. It will be a conventional pre-election budget. Dr. Man Mohan Singh in fact made a beginning with his 1994-95 Budget. His recent speeches have also had unmistakably conventional pre-state-election patterns. For, whether the ruling party does remarkably well, or just so-so, or fares remarkably poorly, a conventional pre-election budget is what the election pundits will order. Actual election scores will only determine the length to which the Budget makers will go in that direction.

So some of the ingredients of the forthcoming Budget will, alas, to be the following:

- continuation of high fiscal deficits;
- a plethora of populist schemes in the name of making a 'frontal attack' [Ha!], on poverty, unemployment, houselessness, illiteracy and all that;
- increase in subsidies;
- petty concessions to income tax payers;

- not-so-petty concessions to appropriate sectors of industry;
- a return to discretionary decisions and bureaucratic approvals.

Such budgets are called 'soft' budgets. I have never understood, why. They hit hard all sections of society; and they hit the weaker sections hardest.

(IV) Interest Rates

It is unlikely that interest rates paid to banks by the bulk 'of industry will see any material reduction. In all probability there will be an upward pressure.

Inflation that refuses to come under control; the high interest rates which even the sovereign government is obliged to pay for its market borrowing; and the scramble among banks for attracting deposits at the highest end of the permitted band are indicators in this direction. On top, the banks must continue to pay liberal pay packages to a vast army of employees, meet their other administration expenses, take care of the non-performing assets and still must make a profit.

Don't let us be carried away even if we see the prime lending rates once again being officially lowered to some extent. The material question is: How much of the aggregate lending to industry does in fact benefit by such a lowering? Probably, some borrowers even with the best credit rating may not be able to procure all their funds requirements at the prime rate. The next best, the medium scale and the rest may in fact end up

pgying the same interest rate as in the past, if not higher.

There will be no shortage of funds for industry. But the interest rates will not come down; and they will not come down, not because of shortage of funds; but essentially because of high inbuilt costs of funds.

It will be a pity if the Government responds to this scenario by reviving the discredited system of directed credit and any administered interest rate structure. Banks and financial institutions should have the freedom to structure their interest rates without ignoring their bottomline. If government in its wisdom at all considers that certain classes of borrowers [including itself] deserve to get credit at a lower rate of interest than what banks will agree to, it is for Government to subsidise these sectors suitably from its own Budget.

(V) Capital Account Convertibility of the Rupee

Should the Rupee be declared convertible on capital account? When?

In corporate circles, there is considerable interest about these questions. In my view, there is no urgency whatsoever about declaring the rupee fully convertible on capital account. Partly such a capital account convertibility has already been achieved by allowing FII's investments with full repatriation rights. There are no worthwhile rewards in taking a full plunge into the darkness of a one-trillion-dollar-a day foreign exchange market. The risks can be considerable. Perhaps Mexican experts may agree.

Curiously, capital account convertibility seems to have assumed a pro-rich image. And in populist attempts to prove that reforms are not pro-rich, the issue may take a back seat. Not bad.

(VI) The Rupee-Dollar Exchange Rate

Assuming that the Rupee has not been declared to be convertible on capital account by then, I expect by January 1996, to see the rupee depreciated in relation to the U.S. dollar from the current 31.37 parity to Rs.33 or lower. It has depreciated already in relation to e.g. the D-Mark or the Pound Sterling. It is the U.S. $'s depreciation in terms of other currencies that to some extent has concealed the defacto rupee depreciation. The actual level will depend on the objective, the extent and the nature of RBI intervention.

On the same assumption, I expect that the foreign exchange .reserves will not exceed the current level of about U.S. $ 20 bln.

(VII) Exports

It is singularly unlikely that our exports in 1994-95 will repeat the last year's performance of a 22% average growth in dollar terms. The growth will be closer to 15% and there is nothing much to mourn about it. To a significant extent, the 22% increase was the response to a spate of policy measures in terms of devaluation and deregulation initiated after July 1991. The 15% growth expected this year is a stable growth

path that can at best be maintained, unless our current double digit inflation is brought firmly under control.

In the coming years, our exports will also face tough opposition from the protectionist tendencies that may come to surface in large areas of the developed world and from the totally extraneous non-commercial factors like child labour, human rights, environment and the like [which together have come to be known as 'social clause']. Considerable thought needs to be given to this emerging problem; and an extremely carefully worked out strategy needs to be worked out to tackle it.

(VIII) Elections

Election fever is once more in the air. Indian industry has once more shown considerable maturity. There is no evidence of any Indian industrialist planning to postpone his investment plans in view of the so-called political uncertainty. 'Politicians may come and politicians may go, we remain here for ever' seems to be their message underlining total confidence in the emergence of India as a force to reckon with in the world economy. That is the strongest parameter of the current economic environment and perhaps the best testimonial that reforms are working.

Quite a few FIIs and FDIs however seem to be rather concerned about this so-called political uncertainty. Curious: because, multi-national industrial and financial companies have taken in stride developments in many other countries such as Russia, China, Japan or Mexico, and even the November 1994 'mid-term elections' in the U.S. itself; Surely, they have also seen change of governments in many countries.

It will be necessary no doubt to constructively consider their genuine demands and grievances. Even then, if they find other countries more attractive, good luck to them. But if they have found Indian competition tougher than what they bargained for, poor luck!

Epilogue

The current economic scene offers an exiting environment for business and industry. But the stark dimensions of some of the challenges and the many splendoured opportunities beyond, have both to be fully appreciated. The environment carries obligations both for Government and industry.

Indian industry has come of age. Government does not have to provide it with any protection from foreign competition. Equally emphatically, Government policy should not go to the length of protecting foreign industry on Indian soil; It does so now in many respects. Government's leisurely and complicated procedures to impose anti-dumping duties; its preferential treatment of levying a lower capital gains tax for FIIs (which itself can be done away with via the Mauritius route), its counter-guarantees given only for some foreign mega-projects when none was even mentioned for any Indian project; its October-1994-GDR guidelines, or its exit policy which allows the benefits of modern technology to foreign entrants, but in effect denies it to existing Indian entrepreneurs, are

some conspicuous areas where our policy is discriminating against Indian industry. Industry has a right to expect better: It is not asking a favour.

On the other hand industry needs to appreciate that it has been an early beneficiary of the overdue reforms process. It is its responsibility to undertake a vast public education campaign to take the message of reforms to the masses – not just to the already convinced audiences at seminars in 5-star hotels. The masses are not only ignorant about the rationale of reforms, they are in fact exposed to a virulent, anti-reforms disinformation campaign. In most countries, which embarked on similar reforms programmes, public education was given a high priority. For various reasons we could not. This lapse if not rectified quickly can prove costly – more so to industry.

I am confident that this task is well within our abilities, once we are convinced that we ought to take it up. I am equally confident that Indian industry can give its world-wide competitors a run for their money.

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Bombay
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II. The Budget We Need

(I) The Scenario

Sorry, the budget scenario is once more getting out of hand:

For 1994-95 there are serious expenditure overruns; e.g. on subsidies, (foodgrains, fertilisers, imported sugar), on interest payments as well as on assistance to States. Tax receipts however will barely meet the budget estimates. On the whole, the fiscal deficit will be closer to Rs.65,000 crore. [Budgetted, Rs.54,915 crore]; and revenue account deficit will again far exceed the budgetted Rs.32,727 crore.

For 1995-96, unless the belt is tightened until it hurts, there is no respite in sight:

(1) Conventional political wisdom will require substantial step-up in subsidies and some other items making up revenue expenditure; and in public sector plan outlay.

(2) The industrialists will continue to demand more concessions, and further reductions in excise and import duties and corporate taxes.

(3) It is becoming increasingly doubtful if the Finance Ministry has any effective control at all on large areas of government expenditure.

Remember that it was the fiscal mess that drove our country to the economic crisis of 1991; and that the top-most priority of economic reforms was to bring back

discipline to budgets. It must be a daunting task for a dedicated and brilliant Finance Minister to talk of irreversibility of economic reforms to every visiting foreign dignitary while watching helplessly the budgets slipping back into the same old uninspiring story.

It is in the context of this scenario, that I will indulge, in all humility, in some loud thinking, on the Budget that we need.

It is for the citizens to assess it and demand what they deserve and it is for our leaders, not excluding the Finance Minister, to consider if, and how far, they can respond.

(II) Guidelines

(1) The Finance Minister should keep the following two overriding considerations always in view:

(i) POPULISM WILL NEVER ALLEVIATE POVERTY. SELF-SUSTAINING ECONOMIC GROWTH AND INFLATION-CONTROL ALONE WILL.

(ii) TAX RATES AND TAX REVENUES ARE TWO DIFFERENT THINGS. THEY SELDOM GO HAND IN HAND.

These should be pasted as mottos in bold type on the walls of his office.

(2) It is not necessary for Government to continue to give protection to Indian industry;

Equally emphatically, it is not our Government's business to protect foreign industry from Indian competition either. None of the fiscal measures should discriminate against Indian industry in relation to foreign industry.

(3) As regards Deficits, following targets should be strictly adhered to for 1995-96:

(i) The 'Fiscal Deficit' should not exceed 5% of the GDP or about Rs.53,000 crores.

(ii) The Budget Deficit should, as promised last year, be reduced further to Rs.4000 crores.

(iii) The Revenue Account Deficit should be targetted to be reduced to zero by 1999-2000. As a starting point, it should definitely not exceed the Revised Estimate of 1994-95 (which I expect to be over Rs.35,000 crores).

(III) Proposals

As regards concrete budget proposals, here are few of vital importance:

(1) There is ofcourse a strong case for a further reduction in the **customs** and **excise duties** in respect of several products, as also in the corporate tax rate. But, any such cuts will have to be postponed. Industry has responded commendably to the tax reductions

in the last two years; and it is now strong enough to march ahead without any further cuts for the time being.

(2) **Gold** has played a crucial role in the lives of all of us Indians, barring a few (like me), who believe that investment in gold is not productive. Government's gold policy must come to terms with this reality:

First, FIIs should be permitted to bring in gold (instead of foreign exchange), sell it in the Indian market and then invest the total sale proceeds in the capital market as at present. [My article in India-Today August 31, 1994 discusses the rationale of this proposal].

Secondly, imports of upto 5 kg. of gold under baggage rules whether by NRIs, by Indians returning after a long or short visit, or even by foreign tourists, should be allowed, without any restrictions.

Thirdly, import duty at present rates should be payable in rupees.

These measures will spell an end of the curse of gold smuggling and will bring valuable tax revenues to the treasury.

(3) **Disinvestment** should be pursued with added speed and with a new dimension. Government should in suitable cases sell well over 50% of the PSU equity and let appropriate Indian private sector agencies take over their management and control. At

least .Rs.15,000 crore should be collected from such disinvestments [1994-95 – Rs.4000 crore]. These collections should be used to retire a part of the government debt.

(4) With immediate effect, **individual income tax** on wages and salaries should be abolished altogether. On other individual incomes, the existing slabs will continue for some more time.

The Finance Minister should accept the persisting reality:

(a) that our individual income tax system has been the most regressive system in practice; penalising the hard working and honest middle class and rewarding the evaders;

(b) that the yield has remained abysmally negligible, irrespective of whether the rates were high or low; and irrespective of any number of amendments to the laws that we make every year; and

(c) that the individual income tax and misdeeds associated with it have become the chief source of the all-prevading bad smell of the Indian economy, and of massive corrupting flows of hundreds of crores of rupees of black money. [This subject is dealt with in details in my book 'Black Money & Budgets'].

Citizens will respond to this bold

measure abundantly and government revenue will not be adversely affected at all.

(5) Steps should be taken to suitably dismantle (a) the Income Tax Act which is routinely described by respected citizens as a 'national disgrace' and (b) the income tax department which, even in official circles, is considered to be 'in shambles'.

(6) A rapid reduction in government expenditure has to be the main plank of restoring sense to government budgets. We have all talked about subsidies, interest payments and defence expenditure. Their 1994-95 nominal levels must be an absolute cap, under any circumstances.

(7) There are several other government agencies and deparments whose size and cost needs a hard look in the context of the thrust of economic reforms. It looks curious, for example, that we have large 'controlling' ministries for those very industrial and economic activities which themselves are mostly in the State sector. For example, we have a huge power ministry 'controlling' the mostly-government-owned power industry; a steel ministry to control the (mostly-government-owned) steel industry; and so on and on. A sharp **downsizing** of many such large ministries and government departments cannot be delayed any longer. All such

Ministires should be identified and their allocations for 1995-96 in money terms should be reduced by 25% over their 1994-95 levels. In real terms, the reductions will be even more sizeable. It should be left to each 'affected' Ministry to lay down modalities of managing within the reduced allocations. Government cannot be effective unless it is lean and healthy and a weight reduction programme is undertaken to shed fat all around.

(8) There is no doubt a strong political justification for stepping up the Annual Plan outlay in **1995-96.** The Planning Commission has studiously made a plea for a 20% increase. But again due to fiscal compulsions, no more than a token 5% nominal increase should be accommodated; and that too only to expedite completion of crucial on-going projects. All investments for new public sector projects will have to be postponed.

(9) The Finance Minister should desist from allocating any public funds to support populist schemes in the name of alleviating poverty, developing rural areas, or creating employment. In the past all such 'schemes' have turned out to be nasty. They never helped the rural poor or the unemployed or the underfed; Instead, they have inyariably benefitted the profusely leaking rusty pipelines. He should not let himself be misundertood as a willing party to such misappropriation of government funds. Rapid economic growth and effective inflation control are the best antidotes to poverty. Our economic reforms with a human face should be tailored to achieve precisely these objectives.

Tailpiece

For the sake of our Finance Minister, let us all start our day with this prayer:

'God, grant my leaders the serenity to accept things that they cannot change;
The courage to change those that they can;
And the wisdom to know the difference:

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