The Indian EXPRESS COLUMNISTS

N K SINGH

Sunday , February 27, 2005

FROM THE RINGSIDE

Can Chidambaram be Santa Claus tomorrow?

On Budget eve, an astrologer rather than an analyst would be more helpful in predicting outcomes. This is particularly so when a new security paranoia has reportedly gripped the Budget-making exercise. Each year, we proclaim to make Budget-making more transparent, but soon revert to our old ways. Chidambaram has multiple woes and can scarcely be blamed for avoiding any whiff of Budget leakage. Premature publication of informed speculation robs the mystique and suspense surrounding any Budget.

On the positive side, Chidambaram presents the Budget when the overall macro-fundamentals of the economy are stable and strong. GDP growth would be around 7% with high growth of manufacturing and services sector. Inflationary pressures have significantly eased, interest rates are moderate and external reserves buoyant. International perceptions about the government remain positive, with medium-term expectations of an achievable 7-8% growth. Within this broad framework, there are no doubt constraints.

First and foremost, the fiscal management. Revenues are below targets even while expenditure pressures have continued to mount. However, expected higher GDP enables better fiscal numbers, coupled with increased non-tax revenues by way of dividends from public sector undertakings, particularly the oil sector. Nonetheless, fiscal rectitude and credibly meeting targets stipulated in the Fiscal Responsibility & Budget Management Bill would remain elusive. As I have said earlier, it will be more truthful to take a break for one year than resort to creative accounting or ‘‘accounting gamesmanship’’ for which technical skills are scarcely lacking.

Second, the difficulty in reconciling a reform package which pleases all segments of the UPA. Significant reforms in further deregulation of infrastructure, banking and financial sector and promotion of FDI would need to be balanced with reforms in agriculture, social sector, urban policies which are pro-poor and employment-friendly. Allegations of pursuing neo-liberal economics need to be balanced with homegrown reforms which are India-specific.

Third, harmonising the interests of various stakeholders. Chidambaram, with the reputation of a Dream Budget-maker, would favour significant tax breaks. There is rationale in reducing corporate taxes to the highest marginal income-tax rates as we remain among the few countries where corporate rates are higher than personal income tax. Leaving income-tax rates stable, tax slabs clearly need adjustment and in future indexed to inflation or carefully designed parameters. Given economic buoyancy, this is also the right time to reduce peak customs duties to preferably 10% or at least 15% with a pre-announced roadmap for alignment to ASEAN rates. There can be no meaningful dialogue on preferential trade agreements in its absence.

On VAT, we can scarcely afford to bend under a concerted campaign of unscrupulous traders seeking greater flexibility, an euphemism for permitting evasion. On Excise, there has been enough adhocism, by creating new rates and clubbing products at preferred rates — to meet short-term exigencies. We need to have no more than three rates — a mean rate of 16% (I don't think Kelkar's idea of 14% is very sensible and may require avoidable, administrative rejig), a lower merit rate of 8% apart from a very select application of a non-merit rate of say 24%. The overall revenue exercise may not be revenue-friendly and improvement of tax-GDP ratio would have to primarily come from adoption of VAT, improved compliance, better administration, more rigorous application of TIN. On the expenditure side, a significant increase in Gross Budgetary Support (GBS) and its inter se allocation between social sector, agriculture, rural development and enhanced provisions for infrastructure is best left to the Planning Commission. However, Special Purpose Vehicles or other financial engineering towards Railways modernisation or resource additionality for infrastructure, both for public investment and public-private partnership, which at the very least create contingent liability, must be predicated on high reform content.

So, all in all, we need to ask the question that given these dilemmas, how should one assess the Budget outcome? In my view, we should judge it on the basis of five criteria:

• First, in Chidambaram's own words, does it lay the foundation for an investment led growth? Will the Budget measures kick off investment significantly in infrastructure, manufacturing and the services sector. This would no doubt depend on the policy content apart from the fiscal stimulus in the Budget proposals.

• Second, does it have the strong underpinnings of deep structural and sectoral reforms? Reforms of agriculture which covers a wide gamut of issues from food policy, crop diversification, easing deleterious regulations and promoting value-added agriculture; urban sector reforms enabling a construction boom and therefore job creating activity; reforms for better utilisation of resources on health and education; completing the unfinished agenda on banking and financial sector reforms; policies which can attract greater private investment in infrastructure and not the least lend credibility to efforts for attracting Foreign Investment.

• Third, to what extent is the Budget, notwithstanding both revenue and expenditure compulsions, in broad conformity with fiscal obligations and will the arithmetic stand up to honest scrutiny than a compliance through a clever number crunching? Expenditure rationalisation and progressive elimination of subsidies through improved targeting of beneficiaries, which was reflected in the White Paper presented to Parliament in the winter session, will be one significant test of Chidambaram's commitment on fiscal rectitude.

• Fourth, no Budget can target all sectors at the same time. Nor can it ignore the benefits of harvesting the low-hanging fruits. Some sectors like Civil Aviation, Tourism, Textiles and Power have seen concerted action and are ready for quantum change. Completing their unfinished grants strategy will have multiplier benefits.

• Finally, all Budget-making is essentially a negotiated compromise with major stakeholders. This includes the coalition partners of the UPA whose views on economic policy, as is well known, are not harmonious. The last Budget proposals of Chidambaram have just about been implemented (though some like insurance still remain) but not without a rather contentious path in achieving intended outcomes. Hopefully, the proposals to be announced would be a fully agreed policy and not mere policy intentions. (Long-term credibility depends on consistency, coherence and commitment to implementing the desired policy changes). And hopefully the policies would not only be balanced but perceived to be beneficial to all segments and stakeholders.

If this be so, Chidambaram could well play Santa Claus tomorrow. He would scarcely be inclined to enact a magical act of creating a transient illusion of bountiful benefits to all at the same time.

*Write to **nksingh@expressindia.com***