Will Pranab deliver a magical budget?

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Tightrope Walking | N K Singh

Every finance minister hopes to be magical on the Budget day. Pranab Mukherjee can be no different; conjure new ideas, discover unbounded revenue streams, saturate expenditure programmes, look to be reformist, please the common man, lift the rural economy and promise a high-growth trajectory.

Few budgets turn out to be dream budgets, but quite a few do get acclaimed as credible balancing acts—the balancing is between good economics and good politics. Compulsions change over time, as do imponderables. New priorities come into play and new challenges need to be addressed. So what is the play between economics and politics that Mukherjee on 26 February will need to reconcile?

First and foremost, to balance taming inflation, particularly since food inflation is spilling over to general price, while keeping growth unhurt. Inflation taming entails a combination of monetary and fiscal policy. On the monetary side, the process of sucking excess liquidity has commenced and we will see further hardening of the cost of credit in the coming months.

On the fiscal side, the two difficult issues are fiscal consolidation and withdrawal of the stimulus packages. While the latter means reversing excise rates to their original levels, perhaps in two stages. Scaling back public outlays is more problematic. Of course, the loan waivers and the outgo account of the Sixth Pay Commission was a sharp, but one-time act. Public outlays by way of gross budgetary support for the Plan expenditure will need a modest increase to fund flagship programmes such as the Mahatma Gandhi National Rural Employment Guarantee Scheme and the Sarva Shiksha Abhiyan.

Besides, rationalizing subsidies is clearly inevitable. Hopefully, the new nutrient-based fertilizer policy will survive the inevitable controversies consequent on the increase of urea prices and other fertilizers. The implementation of the Kirit Parikh Commission report on rationalizing the prices of petroleum products seems to be delayed,

but persistence of large under-recoveries by oil firms will push policymakers to finally bite the bullet. It is regrettable in more sense than one that the more sensible, and by no means audacious, recommendation on dismantling the administered price regime for petroleum products has few takers. Political compulsions smother sensible economics even though it is the poor who bear the brunt of unabridged fiscal deficit.

So the first balancing act is to keep the growth engines on full steam while smothering inflationary expectations and articulate a path of fiscal consolidation.

Second, the difficult choice in orchestration of exit from the stimulus packages, namely proportionate burden between monetary and fiscal measures. The monetary policies usually have longer transmission lags than fiscal levers. Monetary tightening may encourage capital flows with wider interest arbitrage. While interest rates in the US may not remain so accommodative to encourage carry trade, the differentials will be large enough for significant capital flows.

The impact of capital flows on the exchange will hurt exporters and any excessive sterilization by the Reserve Bank of India will, apart from its cost, only reinforce inflationary pressures. Suggestions for regulating capital flows cannot be unhesitatingly accepted. Analysts have, in fact, made a case for greater capital convertibility given our comfortable reserves and if we can accept a path of fiscal consolidation based on the recommendations of the 13th Finance Commission. So the choice between accommodative interest rates, managing inflationary pressures, seeking a competitive exchange rate and continuing the open capital account are difficult macro issues.

Third, decisive policies on agriculture can scarcely be implemented without commitment to wider review of farm laws, labour laws, freer movement for agro-products, improved retail linkages and adoption of new strategies for improving supply-side responses. The government has a lot to answer on the unmanageable price rise of food products, and attributing this to exogenous international events does not wash.

Fourth, the Budget will have difficult choices to make on the time frame for implementing the goods and services tax and the direct taxes code, the non-new financial features of the 13th Finance Commission recommendations beyond enhanced devolution to states. Funding large resources gap for implementing programmes such as the Right to Education or fuller implementation of other flagship programmes coupled with acceptable fiscal consideration is not easy.

Finally, issues connected with energy have become increasingly complex. Within the infrastructure group, the most worrisome concern is the power sector, not only because the large capacity increases still lag behind even after schedules are extended, but efforts to reduce energy intensity are still tentative. The voluntary obligations, both to reduce emission and energy intensity, imply funding low carbon emission growth strategy. There is need to fund research and development on renewables, readaptation of farm practices and implement a revised development matrix.

In short, Mukherjee cannot be envied for tightrope walking. Everyone hopes he will not fall between two stools; by choosing one unduly over the other. Say by being too lax on growth and not stringent enough on inflation, or too much populism over macroeconomic parameters, or seeking short-term applause over long-term gains, and making inappropriate inter-generational choices on climate by excessively rewarding the present over the future.

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