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Return to the Command Economy?

Stray Thoughts after the Union Budget 2009-10.

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I. Political Funding.
II. Fiscal Deficit
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[Alert: Every year, I catch a Budget fever. I feel no relief until some viruses are drained out and reduced to writing.]

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I. Political Funding. [Speech, Para 98]

Proposal: Donations to electoral trusts shall be allowed a 100 % deduction in the income of the donor.
Two cheers. This will bring some transparency to the funding of political parties.
Why not three cheers?
[1] It was Gandhiji's dream that serving in the Lok Sabha will be used a mode of service to the nation. Gandhji hoped that Indian elections would give equal opportunity to all citizens to thus serve the country. He therefore favoured a very low amount as the maximum that a candidate should be allowed to spend on his election. Alas, his dream is shattered. Elections have become a capital intensive industry. So, first our apologies to the father of the nation that we have not lived up to his hope; and there is no chance of our doing so in future.
[2]Secondly, the election industry, with present laws and rules allows only the dishonest to run this industry. To permit the honest also to participate, [a]the expenditure limit has to be scrapped altogether and [b] donations have to be incentivised. The F.M.'s proposal goes some way to meet [b] above.
It will be distinctly superior to permit donations as a 100 % <u>tax</u> credit; not just income credit, as proposed. In other words, if an assessee donates, say, Rs. 5 Lakhs, the whole amount should be treated as tax paid by him and his total tax liability otherwise should be reduced to the full extent of Rs. 5 Lakhs. Such donations will thus amount to state funding of elections [an eminent idea already practiced in some countries, but only discussed to boredom in India]; and in addition will give a choice to the donor to select his donee. Cynics will raise questions to every answer. I have answers to most of them; but that is not the main subject today.

The weakest part of the proposal is the definition of electoral trusts and, even worse, the need for approval of CBDT! Why should the deduction not apply to donations to any recognized political party directly, and without anybody having to see the face of CBDT?

Returning to Gandhiji's dream of equal opportunity to all citizens, there is still a way out: Have a random draw. Nandan Nilkeni's Unique Identification Cards would be in place by that time. Even a basic EXCEL programme will draw a perfectly random list of 544 eligible Indian nationals who could be our representatives in the Lok Sabha. Looks laughable, absurd? Think again. I for one have such an enormous confidence in the talents and honesty of my people at large, and I am so much dismayed at what we have to accept after spending thousands of crores of rupees on elections, that I suspect that a random draw will not throw up anything much worse. In all probability, it may produce a distinctly better Lok Sabha. True, some of the honest, talented citizens as well as those proud of their own current pursuits, if thrown up by the random draw may decline the offer to be a Lok Sabha member. [Remember, when a magazine asked JRD Tata, what was the first thing he would do if he were elected the Prime Minister, he quipped, 'I will commit suicide.' ?] We then keep on drawing more names at random until we touch the magic 544!

II. FISCAL DEFICIT.

'Fiscal deficit', like 'poverty removal' and 'Inclusive growth,' is on the verge of degenerating into a seminar subject in 5-star hotels. So, I was disappointed, but not really surprised to see the casual manner in which this was treated in the Budget. Letting Government expenditure rise sharply at the drop of a hat, without any concern for sustainable sources for requisite revenue is an addiction and so very enticing politically.

On the one hand we insist that we have nothing like a recession [i.e.,'a decline of GDP in at least two consecutive quarters']. At the worst, we have a slowdown in our sharply rising GDP growth rate of recent years. Yet, in size, in urgency, timing and pattern, the series of our fiscal stimuli [i.e., the shopping list for stepping up government expenditure largesse] must match that offered in countries in the midst of the worst crisis they faced in over 50 years.

Naturally, for 2009-10, this will result into an unprecedented fiscal deficit of 6.8 % of GDP [+ States', +subsidies, + + etc]; far larger than the figure that drove us to the feet of IMF in 1991. Yet, we have one single sentence in the speech of 139 paragraphs: 'This level of deficit is a matter of concern and Government will address this issue in right earnest to come back to the path of fiscal consolidation at the earliest.'

Many citizens declined to fall to this lullaby. So the F.M. later came with an reassurance that he had, in fact, already given deep thought to this matter and had quantified Government's resolve, which was open for inspection on one of the many pages in one of the many Budget documents, titled 'Medium Term Fiscal policy Statement.' A due search surely shows up the figures 5.5 and 4.2 as projections of Fiscal deficit for 2010-11 and 2011-12 respectively.

It is however difficult to ignore the perspective [a] that Government has, in one of its many weak moments, enacted the celebrated Fiscal Responsibility & Budget Management Act [FRBM Act]; and [b] that, with rare exceptions, Governments have unashamedly broken it year after year.
When we individuals break a law, we are sent to prison. [Exceptions apart!] But the beauty of this law is that whenever Government breaks this law, [i.e., every year], as a punishment those, if anybody, responsible, have only to file notes of explanation. 'The Macro Economic Framework' and the 'Medium Term Fiscal policy Statement' are two of these notes. They are creatures of the breach of the FRBM Act. As a ritual, these notes assure future corrective action in right earnest, and, soon after the Budget is presented, officials promptly start preparing the next year's notes!
Sharp increases in government expenditure year after year and consequently in fiscal deficits are so inviting. Political vote banks and powerful vested interests thrive on them. But, sure enough, it is a one way street to bankruptcy and humiliation. We in India know all that.

On FRBM Act: [i] Bad behavior can, perhaps, be controlled by a law. But good behavior cannot be ordered by law. I reiterate that this Act should never have been enacted. We knew it will be broken. Such laws only perpetuate disrespect for laws. [ii] The Act is dead for all practically purposes. There is no point and no need to giving it a reincarnation as FRBM II. It is best rescinded forthwith.

My Prognosis for the next five years: [1] Government expenditure has never been reduced. It will continue to rise. [2]Government revenue will never catch up. So, large fiscal deficits have come to stay once again. They will certainly exceed projections in documents, namely, 5.5 % and 4.2 % in 10-11 and 11-12 respectively.
I will not change this view even if there is shown to be an improvement in a particular year. For, this will only herald a sharper damage in the following year.
I am amply convinced that perhaps it is in my country's Kundali [horoscope] that when economic problems emerge on horizon and are relatively more manageable, we do not nip them in the bud, but let them grow into monsters. Then we wake up and take far more drastic, more painful and more prolonged measures. For, these alone can retrieve us from that point. As Johnson put it so well in 1777 in one of his letters to Boswell, "***Depend upon it, Sir: When a man knows he is to be hanged in a fortnight, it concentrates his mind wonderfully."***
It is yet a bit longer than a fortnight.

III. Reforms & Budget.

One view is that the F.M.'s Budget speech is the most important single document that highlights the forthcoming economic policies and approach of the Government. There is nothing about reforms in the speech. It was thus a great disappointment to observers [particularly to the nosy stock market people].

Another post-budget view is that the budget is not everything. It is simply a statement of accounts for the Government. Major policies, for example regarding reforms, will of course come at the right time later. So, the disappointment is unwarranted.

But, if so, the Finance Minister has gone out of his way in his speech to shower lavish praise on Indira Gandhi's 40-year old decision on bank nationalization. He said:

" Never before Indira Gandhi's bold decision to nationalise our banking system exactly 40 years ago - on 14thJuly 1969 – appeared as wise and visionary as it has over the past few months. Her approach continues to be our inspiration even as we introduce competition and new technology in this sector."

[Para 38].

I will not go here into the merits of bank nationalisation. But there are[alas or bravo ?] many who believe [a]that bank nationalization was the curtain-raiser of the disastrous 20-year plus era of the license permit raj and the command economy that pushed India back, and therefore [b] that reforms were all about undoing the damage done then. But here we have our finance minister who is happy to declare where his heart really is and where his inspiration really comes from; never mind if dutifully he has to go on introducing reforms[competition, new technology and all that] for public consumption. This finance minister is in no danger of the TIME magazine placing him on their cove as the 'World's Best Reformer'.

Similarly, summarizing Budget estimates , the F.M went out of his way to announce in Parliament that during 2009-10 the total expenditure is estimated to be Rs. 10,20,838 crores; and that for the first time the expenditure figure will exceed Rs ten lakh crores , as compared to some [pitiably?] small amount decades ago. My T.V. did not show an apologetic finance minister, in mourning that expenditure was going out of hand and needed to be checked. It showed a proud F.M., celebrating an achievement of a big Government, bigger and bigger year after year.

Worldly wise people however could not be expected to celebrate such signals of a return journey. On policy platforms as well as in the markets they will hope for better in future. The stock markets will surely improve one day. But it will be another story; not a result of their waking up to something they had missed altogether. The Budget scar in round one will not be erased.

[IV] Economic Survey:

This year the usual three-day life of the Economic Survey was more eventful. As usual any policy prescriptions[PPs] that the Survey contained were searched with all the media –hype, to discover clues about the likely shape of the Budget that was to follow within thee days. Most glancers of the Survey found long long lists of PPs needed, lists so unparalleled that some 'experts' declared that the Survey authors were talking through their hat; the PPs were extravagant and not practical at all, and all that.

Not for the first time again, the budget that followed was found to be at variance with the PPs in the Survey. Not only the Budget speech was without a word about reforms, the finance minister's approach, as partly seen above, revived for many the chilling memories of the forgettable decades of the command economy . As usual again, the Survey was soon forgotten and its copies were, I guess, dispatched to adorn the reference libraries of government organizations.

Having been an economist of sorts, I cannot resist a few observations:

[1] This is an official G o I document; is published, usually two or three days in advance of the Union Budget. AS explained, during this interval, the Survey is greatly in demand. Hardly anybody actually *reads* the whole of this bulky, rather dated and [this year was a pleasant exception] drab document. I will be surprised if more than one hundred individuals can truthfully claim to have read the Survey during this interval. As my magnifying glasses were missing then, I myself could read only a few portions from its online edition and from the print media reports.

[2] The response to the Survey this year has been harsh. This, I take it, is a document by economists. A true economist should have the courage to say whatever he, after full study, considers to be in the best interest of the country. He is not there to win any popularity contest, and therefore must not be bogged down by doubts about the political acceptability of his considered views. People like Milton Friedman, and my own respected guides like J.R.D and Sumant Moolgaokar invariably supported me, and in fact demanded this from me. An economist's writing should wake up society to see the valley between what is really good for the country and what the politicians are feeding the country with. I was therefore gravely distressed to see, particularly reputed *economic* newspapers criticising the Survey not because any of its proposals were wrong on merits but because it is extravagant and not practical. Practical, my foot!

[3] For its economist authors the Survey must have been at once suffocating and pleasing. Suffocating, [a]because, ignoring the lip service, no body examined their views on merits, let alone compliment them for their selfless effort; and [b] because their hard work is so quickly forgotten. Pleasing, because the finance minister and the political bosses in general let them publish views so far removed from their own cherished intentions.

[4] One reason why the P.P.s in the Survey have come to such a sharp focus this time could be the manner in which they are presented. Most of the chapters discuss the developments in 2008-09 in a particular subject, and then contain 'boxes' which in summary form gives lists of reforms called for in that subject-matter. For example, chapter 2 is about 'Challenges, Policy Responses & Medium term Prospects'. There are at least five boxes [2.3 to 2.7]. Box 2.3, e.g., gives a list of 13 PPs [mostly one line for each] relating to "Fiscal Sustainability & Tax Simplification." The total number of PPs in these five boxes within this chapter is well over 50. A quick glance at these forbidding lists was enough for 'experts' to brand the PPs as extravagant, sweeping and all that. There was hardly any critical assessment on merits of any of these PPs. Economic Reforms is far too important and far too vast a subject to be cluttered up into a number of lists of one-liners in a relatively dull document. This was most unfortunate because almost each of these one-liners is a pearl of wisdom.

[5] Unfortunately, the PPs are valuable pearls only individually. The seductive necklace is missing. As a group, the PPs fail to lure the political class as a whole, much less the public sentiment at large, in favour of the process of the unfinished reforms agenda. Not only many more pearls of diversified properties are needed, we need skilled and dedicated craftsmen to transform these into an irresistible necklace [and other forms of jewellery] that the people at large will yearn to possess and will coerce their political leaders to acquire for

them. As Abraham Lincoln said, **'With public sentiment, nothing can fail. Without it, nothing can succeed. Consequently, he who moulds public sentiment goes deeper than he who enacts statutes and pronounces decisions. For, he makes statutes or decisions possible or impossible to be executed.'**

[6] As in some other countries, we too need a couple of highest quality public policy think-tanks to thus mould public sentiment. Even a cursory perusal of the long list of PPs scattered all over the Economic Survey was adequate to re-convince me that such a think-tank will already have its work cut out for it for at least two years. Until then reforms may keep on coming, but in small change, mostly in jerks and probably in response to external shocks, not from within.

[7] The Economic Survey should be best discontinued. Not because it is too bad; but because it is too good. It is a waste of talent and hard work. It is a public display of utter disrespect year after year to its PPs. The major portion of its contents, in terms of pages, is by way of a review of developments in the previous year. There is nothing great about it; the same work is done at least equally competently by some others, e.g. by the RBI's Currency and Finance Report or by its Annual Report. The Economic Survey merely duplicates it, and not very sensationally either.

V.TAILPIECE : Kautilya

Obviously, the finance minister has enormous respect for Kautilya. [Who does not?] He quotes Kautilya twice and insists that he is acting as per advice of Kautilya.
After one quotation [Para 32], the F.M. says 'I intend to take Kautilya's advice and return to the FRBM target for fiscal deficit at the earliest..'
The F.M. yields to the temptation of re-visiting Kautilya once again just '**before I** turn to my tax proposals' [Para 78]. 'Collect revenue as it becomes due. Avoid taking wealth that is not due because that will make people angry.' He recalls Kautilya's message, which I am sure, his tax proposals translate into action.
Frankly, in either case, this is all less than clear to me. But that does not really matter, if the finance minister is really convinced that Kautilya would have patted his back.
But I am a Kautilya fan too. I remember another of his messages: 'If you place a drop of honey on the tip of the tongue of a person, it is impossible that he will not suck it in. Similarly, if the king hands over the keys of his treasury to a watchman, it is impossible that he will not help himself at all.' Alas, Kautilya did not explain what would happen if barrels of honey are flowing down the streets all over; nor, if it made any difference to the watchman if the treasury is full of own or borrowed or printed wealth.

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