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MORE ON BUDGET '12-13

Ensuring Gloom

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THE UNION BUDGET FOR 2012-13 and the Economic Survey 2011-12 signal three issues of significance about the UPA government's understanding of the economy and its capacity for economic management. Firstly, that the government has lost control over public finances and its ability to shape the way the economy evolves. Secondly, even as growth decelerates rapidly, the government does not have the good sense to look this squarely in the face and come up with a credible economic revival plan. And finally, despite the rhetoric of inclusion, government has reaffirmed its commitment to neo-liberalism by according to global and domestic private capital the central role as drivers of investment and therefore of growth.

Economic growth in the year 2011-12 was 6.9% as against the government's estimate of 9.7%. On the supply side this decline was caused by sharp falls in the rates of growth of agriculture and manufacturing. The rate of growth of agriculture declined from 7% in 2010-11 to 2.5% in 2011-12. And the rate of growth of manufacturing fell by half from 7.6% to 3.9%. As a result of this the economy's dependence on the low value added service sector increased, accounting for upwards of three-quarters of GDP growth. On the demand side, even though there has been some slowdown in private final consumption expenditure, the bulk of the decline is explained by sharp decreases in investment growth and in government consumption expenditure. This growth has been associated with a widening trade deficit, on the back of a widening non-oil trade deficit, and near-double digit inflation. An economic situation with high inflation, a decline in the rate of growth as a result of a slowdown in investment and a rising trade deficit, unless reversed, would lead to a fall in jobs and wages contributing to a fall in consumption and output. This would necessarily result in further widening of income inequalities along with a lower rate of growth. What the government is unwilling to face up to is how bankrupt its growth model is.

There is little doubt that the RBI's anti-inflation policy has been a failure. High interest rates that have raised the cost of capital are at least partially responsible for the investment slowdown but have been much less effective in tempering consumption growth. This implies that despite high inflation of wage and essential goods, consumption did not decline but has continued, out of sheer necessity or even distress. This brings out the fact that the present phase of inflation has had a disproportionately large impact on the working class.

In 2011-12 the budget deficit has shot up to 5.9% of GDP from 4.9% in 2010-11 when in fact the government had estimated the deficit for 2011-12 at 4.6%. Despite the government's claim that the culprit is a rise in public expenditure, the primary cause for the growing budgetary deficit is the inability of government to raise sufficient tax revenue. In fact by the government's own admission it has failed to collect personal income and corporate taxes to the extent of Rs

32,000 crores in 2011-12 as compared to the budget estimates made in February 2011. Year on year the UPA government has handed out tax reliefs and concessions wherein the revenue forgone has come to be nearly 75 paise of every rupee collected in taxes and as a proportion of GDP the revenue forgone exceeds the budget deficit. Had the government followed a policy of progressive taxation over the last five years and sustained the 2007-08 tax-to-GDP ratio of around 12%, the budget deficit would have been in the region of 4% that would have made the economic situation a little more sustainable than it is.

The present budget has accentuated the revenue crisis and created tax imbalances that favour the rich and place an excessively large and increasing burden on the working class. The UPA government has passed on substantial personal income tax breaks to those in the upper income bracket. This budget has passed on a tax relief of Rs 22,600 to every person who earns Rs 10 lakhs and more. These tax breaks have come along with an across the board 2% increase in the service tax from 10% to 12% and extending service taxes to just about every sphere of economic activity. Significantly, all healthcare services in the private sector are covered by Service Tax. With 75% of health services nationwide in the private sector, this places a clear and direct additional cost on working class. While government in principle is correct to increase excise duties by 2% - to 12% - in order to get them back to the 2008-09 level of 14%, when accompanied with personal tax breaks to the richest and a reduction in customs duties on imported cigarettes it clearly signals government priorities. With a commitment to 'fiscal prudence', government promises to cut the subsidy bill to less than 2% of GDP. The reduction of subsidies on fuel, prices of food and other essential commodities will push inflation up further. Despite claims of increase in money wages and inflation being triggered by wage inflation, the RBI admits that this wage increase is limited to a salaried section that has now been further appeased by the income tax break.

The budget seeks to directly attack working class earnings through the reduction in the allocation for the Mahatma Gandhi National Rural Employment Scheme from Rs 40,000 crores in 2011-12 to Rs 33,000 crore for 2012-13. With allocations for the MNREGS being virtually frozen for three years now since 2009-10 the cut this year in real terms, when adjusted for inflation, amounts to about Rs 17,000 crore. The scheme has been significantly eroded in the last year. The Economic Survey acknowledges that the MNREGS was extended to only 3.8 crore households in 2011-12 involving an expenditure of 21,124 crore. In comparison up to the same date in the previous year, the scheme had reached 5.3 crore households with at an expenditure of Rs 29,822 crore. There is by now significant evidence that the MNREGS is in decline. By reducing the budget allocation government has signalled that it is not government's task to foster job creation despite the fact that the 11th Five Year Plan created less than a third of the jobs that it promised to and agriculture remains in a near permanent peril. Further, through minor tinkering of the amounts allocated for the National Rural Livelihood Mission, the Prime Minister's Employment Guarantee Programme and other such minor programmes, government expects to create millions of jobs through self-employment programmes. Promoting self-employment for the desperately poor is the government's answer for an inclusive growth strategy.

On provisions for health and education government expenditure, if deflated for inflation, remains virtually frozen. There are no additional provisions for workers' social security. For a government that expresses commitment to building a 'knowledge economy' the core nutrition programmes of ICDS and the mid-day meal remain under- funded. The budgetary support for the current, and woefully inadequate, National Food Security Bill before parliament is also underfunded. Hence, the 'knowledge economy' is for the few, while hunger, malnutrition and ill-health must be the case for the many.

The budget has significantly reduced customs duty, up to zero, on a host of capital goods including construction and mining equipment, thermal power plants, aircraft parts etc. At a time when the trade balance is out of control most of all because of the growing trade deficit in capital goods this move would only further undermine the sustainability of the economy and increase import dependence. Many subsectors of the manufacturing where customs duties have been lowered are also key areas where capital and governments of the global north have pressed for lower tariffs through a variety of free trade agreements. As these bilateral agreements have in many cases come under attack government has acquiesced by opening the economy by stealth.

The concessions for retail infrastructure, namely cold chains and warehouses, are in advance of a government still in search of a party-political consensus on multi-brand retail allowing corporates to lay the ground until government can get there. The flagging private airlines, built on debt to public sector banks, are now being given an opportunity to revive themselves through External Commercial Borrowings which are by now a well known route for round-tripping black-money. And yet government is simultaneously promising a whitepaper on black money.

The government's decision to retrospectively plug the loopholes on capital gains taxes for foreign firms and also raise duties on large cars and imported vehicles is, in the larger scheme of things, minor tinkering.

The real meddling of course is in the government's efforts to prime the stock market. The lowering of the Securitises Transaction Tax is unwarranted, particularly for a revenue strapped government. And the additional personal income tax-break up to Rs 50,000 in the stock market investment is bait to middle-income households to indulge in speculation, and supplant volatile foreign portfolio investment. This attempt to draw small investors into the stock market comes at a time when only household savings appear to be sustaining while rates of growth of both private corporate and government savings are declining rapidly. The stock market is indeed in trouble with the crisis in the global north deepening and net-foreign portfolio investment have been virtually wiped out in the last twelve months. But to use small-investor money to revive a volatile stock market to bailout the government's disinvestment policy is insidious at best.

The Finance Minister places paramount emphasis on economic revival through "domestic demand driven growth recovery". Cutbacks in income support and social security expenditure, increases in indirect taxes and subsidy-fed private investment cannot boost effective demand. If government does succeed in implementing its budgetary proposals it will contribute to declining job creation and therefore impose an additional downward pressure on wages. Persistent inflation, for which government has no answer, will continue to squeeze the share of wages and further erode real wages. The concerns and interests of the working class apart, this would infact squeeze domestic demand in what is unambiguously a demand constrained economy. People are left today with a tired government promoting a growth model in ruin and politically cornered, choosing the easy way out of squeezing the middle and working class in the name of fiscal caution. □□□