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BUDGET 2012-make or break Budget

By S L Rao

The Railway Budget was bold and comprehensive. It tackled the major issues of safety, hygiene, improving railway stations, catering, management structures, technology, efficiency and many others. It did what no one expected given that his boss is Mamata Banerjee who has sacked him. It raised passenger fares by 10% or so (though if the government had been sensitive, the lowest classes would have been avoided). He substantially raised freight rates earlier and hinted at fuel as a pass through in tariffs in future. The idea of setting up an independent regulatory authority fo determining railway tariffs on an objective basis is long awaited. He proposed much greater dependence on the p-p-p model so that private resources could be used for investment, for example in improving railway stations. Dinesh Trivedi might lose his present job but he set the tone for expecting a bold and thoughtful national Budget two days later.

In my last column I had concluded by setting out my expectations of the Budget, thought I did not expect them to be achieved: “the challenges in this Budget are to keep inflation under control, revive growth, savings and private investment, reduce the fiscal deficit, accelerate public investment, prevent large fluctuations in the Rupee, make India cost competitive for exports, control imports and especially the value of oil and gas imports, and improve efficiencies of government expenditures”.

This government has shown gross incapacity to manage a coalition and work to an agreed programme. The Finance Minister has to negotiate the Scylla of economic objectives and powerful regional parties that are dead set against any increases in government controlled prices. The Budget had to stimulate growth, keep inflation under control, enabling interest rates to come down, keep government borrowing down, and reduce the fiscal deficit by raising revenues and cutting subsidies. The “Mint” argued recently that the fiscal deficit is not relevant; debt is. It ignores analyst and market sentiment and also that deficits lead to government borrowing, crowding funds out from private investment, and to higher interest rates.

Past Budgets unsuccessfully relied on public sector share sales without ceding government management control (disinvestment) and resource sales (like spectrum). It muddied government image for probity as with telecom, murky deals as with capital expenditures on oil and gas losing revenues for government, or with land development rights to the Delhi airport operator. Protecting future government revenues from overseas deals for Indian assets (like Videocon) has led to retrospective legislation, a negative to FDI, though the Minister has said that it will be used only for deals over the last six years.

The most positive element in the Budget is the slew of measures on infrastructure-more tax-free bonds, external commercial borrowings, extension of tax benefits, expanded redefinition of infrastructure, possible FDI to 49% in airlines, etc. Expanded usage of viability gap funding will have a multiplier effect and stimulate growth. The road construction targets are ambitious but the experience of the last few eyars should make contracts better and contractors more subject to supervision.

Government has missed targets in past years on power and roads, especially by public sector companies. In the case of power it is because preference to BHEL has led to delays in equipment delivery and higher costs. To discourage cheap imports of super thermal and ultra super thermal equipment from China, BHEL, L & T and other new producers of such equipment were to get 19% customs duty protection, but fortunately, there is nothing in the Budget. With severe power shortages and delays in public sector power generation, timely delivery and quality of such equipment is essential. The new producers have yet to establish their credentials. Government and the RBI between them have raised the cost of capital and private investment has suffered. Measures in the Budget will help substantial private investment in power, roads, and many other infrastructural areas.

Coal supplies have been a problem and the duty concessions to coal mining equipment will help improve production and lower costs, as has happened with captive mines in the private sector. It would have been better if Coal India merely held ownership of mines and leased them for operation to the private sector, and a Coal regulator determined coal prices.

There is little to stimulate FDI in this Budget. Consumption expenditure will be hurt by higher indirect taxes (excise duties and service taxes on more items). The income tax concessions will add only a fraction to disposable incomes compared to the outgoes on account of higher indirect taxes. The economy is notlikely to be stimulated by consumption expenditure as it will by infrastructure investment. The lack of incentives to corporate investment (for example, depreciation and investment allowances) is disappointing and private industrial investment will suffere high capital costs and limited market growth.

Measures to reduce black money and money laundering are a rehash of old measures. It almost appears as if vested interests in government do not want much to be done to reduce them. Apart from these losses to the economy, nothing is there in the Budget to reduce the massive waste and theft in spending funds on government programmes. The idea of cash transfers I s hoary chestnut and does n ot address the question of identification of beneficiaries. Hopefully, the UID number and the micro banking services through banking correspondents will help but all this will take many years to be effective.

For some years now this government has done little on public investment in agriculture. In this Budget, agriculture continues to receive less investment attention except for some research investment. Dams and canals as well as watershed development should have been a major priority but are not. Storage is to get a push but still quite inadequate to prevent open air storage. There is no mention of cold stores. Productivity is declining for almost all crops and there are no measures for improving it.

There is a commitment to cap subsidies at 2 % of GDP. This will require around Rs 10/ per liter increase in diesel prices. Given the political furoire this will create, it may not happen. In either event the taxes will push prices up in summer when in any case inflationary tendencies are strong. Inflation will be a major worry in coming months. It is not surprising that the RBI has not reduced interest rates, especially since inflation seems to be resuming and will get worse with these measures and with rising crude oil prices. With interest rates remaining high, industrial recovery will remain weak, as will the export effort.

It is wrong to attribute the Budget's deficiencies only to coalition compulsions. More could have been done without provoking opposition. The Budget does do some things right, especially on investment but fails on many other fronts. It does not ensure growth or assure that inflation will remain under control.

With general elections due in 2014, this is the last year that the UPA could take bold decisions. It has not taken them. This will ensure that the economy will be under stress and that the 2014 elections will be fought on economic grounds and a Congress party that had led the country down badly on what was assumed to be its strength, namely economic management.