READING BETWEEN THE LINES

We hope there will be a gap between the populist rhetoric and reality

THE BIG PICTURE

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ILLUSTRATION BY BINAY SINHA

The last Budget before an election is a time of fiscal pressure. At first blush, the Budget numbers look reassuringly good. The primary deficit is projected to decline. Total expenditure is projected to grow by 10.1 per cent, which is actually lower than the 12.3 per cent growth of last year.

Upon closer examination, however, we see areas for concern. The expenditure on bank recapitalisation has not been recognised in the Budget. Gross tax revenue growth, which was 13.4 per cent last year, is projected to go up to 16.7 per cent, which may be hard to achieve. The situation on proceeds from privatisation has been worse than meets the eye.

There is a lot of text in the Budget Speech about populist expenditures. We hope there will be a gap between rhetoric and reality on these fronts. The Budget estimates are not alarming while the text of the speech is. Careful analysis, and more information, is needed before we can judge the fiscal impact of numerous actions that have been taken on the expenditure front, and judge the extent to which the text of the speech may or may not be consistent with the numerical estimates.

I was particularly concerned over the talk about universal health care. Population-scale welfare programmes are extremely dangerous in the magnitude of expenditures involved. As an example, nobody in India had understood in 2001 that the Net Present Value (NPV) of expenditures on account of the civil servants' pension, counting only present workers and pensioners, was over 60 per cent of GDP. This was a defined benefits pension programme that did not even cover the entire population, but it was shockingly expensive.

Similarly, the words "one-rank-one-pension" (OROP) readily trip off the tongue, but this potentially involves tripling or quadrupling the implicit debt, when compared with the simple nominal pension. Common sense is not a useful guide to thinking about these problems. Building a highway or an airport is a controlled expense, but population-scale welfare programmes can easily degenerate into uncontrollable and massive expenses.

Public finance in many a country has been torpedoed because of mistakes on this front. We in India have suffered from one major mistake so far of this nature: OROP. We should try hard to not make another mistake on setting up entitlements.

We have to thus be extremely careful before promises are made about health programmes. The words "universal health care" readily trip off the tongue, but thorough fiscal analysis should be undertaken before any promises are made. In the Indian case, such calculations were done when the National Pension Scheme (NPS) was introduced in December 2002, but not when OROP was debated.

Going beyond the fiscal dimension, universal health care is an extremely complex puzzle interweaving issues of market failures in health, health system design, and the envelope for what is feasible by way of state capacity. Considerable policy thinking is required in designing the strategy for reforms, and the feasible sequence in the construction of state capacity. At present, that level of preparedness in policy thinking is not in place.

Every Budget Speech shows a work programme for fiscal, financial and monetary institution building. The Budget Speech is a set of promises about the work that the Ministry of Finance will undertake in the year. This is an area where considerable policy thinking is in place, and year after year, one building block after another has been put into motion. This year's announcements are disappointing: There is little movement on the main work programme of macro and finance reform. After a few years of major achievements—Insolvency and Bankruptcy Code, inflation targeting, Securities and Exchange Board of India (Sebi)/Forward Market Commission merger, Financial Resolution and Deposit Insurance Bill, Foreign Exchange Management Act amendment—it was surprising to see the lack of follow-through on a well understood agenda for reforms.

The speech says that Sebi will consider forcing firms to obtain a quarter of their financing through corporate bonds. This would be a real mistake. This would take us back to the days of central planning, where the government determined what private persons did. This is the wrong way to think about the corporate bond market.

We need to undertake the fundamental reforms through which India will achieve a well-functioning bond market. The reason this has not come about so far lies in mistakes in public policy, and these mistakes need to be addressed. Once the bond market works well, self-interest will drive private persons to use it. It is not correct to use coercion to push private persons to use the bond market, just as it is not correct to use subsidies to push private persons to use digital payments. The actual gains to the economy come not from the numerical magnitude of bond market issuance but from the improved efficiency that comes from a well-functioning bond market. Coercion allows us to claim victory on the former without the latter.

How does the Budget announcement shape the macroeconomic scenario for the coming year? The economy has faced difficult conditions from 2012 onwards. The early evidence shows some improvements towards the end of calendar 2017. The early results of a few listed firms, for October-December 2017, show gains in output and profitability. The CMIE labour market data, for September-December 2017, shows an improvement in demand for labour.

In this mix we now face a few difficult problems. Global tradeables prices are rising, which will put pressure on inflation and interest rates. A few mid-course corrections may take place on spending, owing to the proximity of the elections. The fiscal deficit may prove to be larger than estimated, on account of the bank recapitalisation (which has not been counted in the budget estimates), and potentially on account of fiscal slippage through the year. This will make a claim upon net savings, it will feed into the current account deficit, and thus the exchange rate and inflation. It will also generate pressure on the bond market with large-scale issuance. We are thus at an interesting combination of rising stress interacting with a nascent recovery.

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