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Govt's fiscal profligacy has made a mockery of the FRBM Act

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Chaitanya Kalbag

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The government's fiscal profligacy has made a mockery of the FRBM Act.

Pranab Mukherjee sounded pleased earlier this week when he told a TV interviewer that India's projected fiscal deficit of 6.8 per cent of GDP in 2009-10 was still better than the 11 per cent projected in the United States. He did not mention the difference in the two countries' GDPs, and he was not cross-examined about India's budgeting process, which is in the grip of multiple sclerosis. This ailment is characterised, the dictionary tells us, by "inability to coordinate movements, blurring of vision and an abnormal tingling sensation".

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The abnormal tingling was evident in last Monday's precipitous fall in the Sensex, which rocketed 52.57 per cent between January 1 and June 30 this year. In itself, that was aberrational behaviour considering that market capitalisation has fallen from a peak of about 140 per cent of GDP in December 2007 to 50 per cent of GDP in February 2009, as the Asian Development Bank (ADB) has noted. In comparison, the Dow Jones Industrial Average has actually fallen from 9,034 on January 1 to 8,447 on June 30, and the Americans know they are not out of the woods.

The warning bells are ringing loudly. Rating agencies have put India on notice for downgrades; Standard and Poor's cut India's long-term sovereign debt outlook to "negative" from "stable". The ADB warned that fiscal stimuli can only have a short-term impact. "At a time of falling business confidence, expansionary fiscal policies could impair the confidence of investors unless clear signals are given that the present large deficits are truly temporary. General government debt is estimated to be 80.7 per cent of GDP (at end-March 2009), indicating little room for fiscal manoeuvre."

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The UPA government's fiscal profligacy, abetted by the Reserve Bank of India (RBI), has made a mockery of the Fiscal Responsibility and Budget Management Act (FRBMA), which requires the government to cap fiscal deficit at 3 per cent of GDP and eliminate revenue deficit. The finance ministry acknowledges that the discipline imposed by the FRBMA enables the state to channel huge new funding into social-sector spending. The difference this time is that reckless spending has ballooned and lawmakers have become lawbreakers. The Economic Survey noted that the government's fiscal stimulus, including higher salary payouts to state employees after the Sixth Pay Commission report, equalled 3.5 per cent of GDP last year.

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How are government policies hurting business, manufacturing and capital formation? There are some clues in recent reports. The government plans to borrow Rs 40,000 crore from the market this year. RBI noted in its April policy statement that the combined central and state fiscal deficits, plus special securities issued by the Centre outside the market borrowing programme, would take the nation's fiscal deficit to 10.8 per cent of GDP.

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This means that private-sector borrowers will be crowded out of the market by the government-central bank behemoth. The gloom in the corporate sector is reflected in the National Council for Applied Economic Research's (NCAER's) Business Confidence Index, which declined to 81.9 at end-March, a 45 per cent plunge from 148.7 a year earlier and the lowest since October 2001.

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Industrial production slowed very sharply to 2.4 per cent in 2008-09 from 8.5 per cent a year earlier. Exports and imports both declined; trade deficit soared 35 per cent to \$119 billion. Exports in April and May this year plunged to \$21.8 billion, 31.2 per cent down from a year earlier, and imports fell even more sharply to \$32 billion, a 38 per cent drop. Foreign exchange reserves declined by nearly 17 per cent to \$262 billion at end-May.

Employment has also taken a huge hit. Unemployment figures are poor estimates since 92 per cent of the workforce is in the "informal" or unorganised sector. On the ground, it is clear that millions of people have lost their jobs in gems and jewellery, textile, leather and small and medium businesses as well as automobile, tourism and transport sectors. Internal investment has plunged —growth in fixed capital formation declined from 12.9 per cent in 2007-08 to 8.2 per cent in 2008-09.

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As an example of how carefully unemployment statistics need to be scrutinised, government figures show that employment in the organised sector grew from 26.73 million people in 1991 to 26.99 million in 2006. In other words, only 2.6 lakh workers were added to the workforce during these 15 years while the country's population grew from 839 million to 1.12 billion.

Exactly how many people are out of work? The government estimates that the number of jobless totalled 36.7 million in 2006-07. It predicted optimistically that this would fall to 23.3 million in 2011-12. But that was before the global crisis.

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Even when times were good, and the economy was growing strongly, Planning Commission figures show that unemployment rose from 6.1 per cent in 1993-94 to 7.3 per cent in 1999-2000 and 8.3 per cent in 2004-05. Unemployment among farm workers rose to 15.3 per cent in 2004-05. Growth in real wages of farm workers slowed down in the 2000s as agricultural growth decelerated.

Why is it critical for India to get its act together and put business back on track? If the external situation does not improve, the government has to find more revenue internally. The Economic Survey made a strong argument for disinvestment, saying the government should aim to raise at least Rs 25,000 crore annually from stake sales of up to 10 per cent of equity to the public.

Mukherjee is aiming for a far more modest Rs 10,000 crore this year. The Survey also sets great store by the introduction of the General Sales Tax by April 2010.

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Nowhere is the government's failure to strengthen the foundations of the economy more evident than in the inexcusable delay in enacting world-standard legislations. The Companies Act of 1956 is due for a thorough cleansing and tightening, but amendments have risen and died in a succession of Parliaments. The Banking Regulation (Amendment) Bill 2005 is hanging fire. India's taxation rules need urgent simplification, and Mukherjee referred in his Budget speech to the need to end "coercive tax collection methods".

He also highlighted the newly set up Competition Commission: "The benefits of competition should now come to more sectors and their users and consumers." He chose not to mention that the Competition Act of 2002 languished for seven years before becoming law in May.

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