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Fiscal destabilisation

A fundamental reason for the setback is the adventurism on excise and customs duties, says **Uttam Gupta**

THE revised estimate of the fiscal deficit for the year 1993-94 has been placed at a monumental Rs 58,551 crore. By government's assessment, this translates to 7.3 per cent of the GDP. However, this assumed a GDP of Rs 8,02,068 crore which appears to be inflated. In fact, working on the basis of a GDP of Rs 6,29,700 crore for 1992-93, together with a real growth rate of 4 per cent and average inflation rate of 7 per cent for 1993-94, the GDP for the year 1993-94 should have been Rs 6,98,967 crore. With this as the denominator, the fiscal deficit of Rs 58,551 crore should thus be even higher at 8.4 per cent. This is almost the level prevailing in 1990-91.

Inflation rate, estimated at 8.5 per at the end of 1993-94, is half the 17 per cent in August 1991. This may sound impressive. But, we should not be oblivious to what is in store for us in the ensuing year. Already, the stock of money in the economy has increased enormously due to an uncovered budget deficit of Rs 9,060 crore during 1993-94, on the one hand, and the RBI having bought an unprecedented US $6 billion to prevent further strengthening of the rupee on the other. Together with the proposed deficit of Rs 6,000 crores for 1994-95, likely to increase during the course of the year as per past conventions, this is bound to increase further. On the supply side, even as the honeymoon that we enjoyed in agriculture due to good monsoon for six years in succession may not repeat, the contemplated industrial recovery also appears to be doubtful, particularly with investment by government not increasing and private sector still not knowing precisely what to do with the money that it has mobilised from different sources. Increases in the administered prices of practically all basic items including foodgrains and petroleum products immediately prior to the presentation of the budget will only aggravate inflationary tendencies.

Reduction in current account deficit to just about 0.5 per cent of the GDP in 1993-94, down from a high of 3.3 per cent in 1990-91, sounds commendable. Indeed, the finance secretary has even sought to use this to justify backtracking on fiscal discipline. But, considering virtually no increase in imports during the year, this is more of an aberration. Several key factors point towards the distinct possibility of a sharp spurt in imports n the ensuing year. These include the expansionary effect of the excess money supply in the economy, further lowering of the custom duty, increase in the international prices of crude oil and petroleum products and the contemplated opening up of the flood-gates of consumer goods.

On the export front, it is doubtful whether the growth rate achieved in 1993-94 will be maintained. Double-digit inflation by itself is bound to erode the competitiveness of exports.

Exports may also suffer on account of the possibility of the rupee becoming stronger due to increasing inflow of foreign exchange, primarily on the capital account. After all, the RBI can't go beyond a certain point in mopping up dollars from the market.

Finally, we should not forget the element of substantial exaggeration in the exports statistics for 1993-94 in view of the over-invoicing of exports.

Increasing foreign exchange reserves to more than US $13 billion is also not something to be happy about. Much of the addition during 1993-94 has come in the form of portfolio investment. In fact, the foreign direct investment approved (actual is even lower) is just about US $500 million. These funds are highly volatile and can do real damage either by way of fuelling inflation in the economy or alternatively by hampering export effort due to appreciation of the rupee.

Clearly, the macroeconomic stabilisation programme has received a serious set-back. And, the predominant reason for this is the inability of the government to control the growth in non-plan expenditure. During 1993-94, the actual has exceeded the budgeted provision by a whopping Rs 7,774 crore. This, by itself, is suppressed as substantial expenditures have been postponed to 1994-95.

With regard to increase in interest liabilities, the government continues to cry hoarse about the excessive borrowings of the past. At the same time, it refuses to shun this practice.

Only the methodology/modus operandi seems to have changed. For instance, during 1994-95, although a ceiling of Rs 6,000 crore on treasury bills purchased by the RBI has been placed, government borrowings will continue by way of 364 days treasury bills and coupon bonds issued to commercial banks.

Another fundamental reason for the setback can be directly attributed to the adventurism of the finance minister in reducing customs and excise duty without putting the tax collection machinery and other institutional paraphernalia into gear.

Commenting on the by far most successful 1991-92 budget in terms of achieving the fiscal goals, when some critics pointed, at that time, to the tremendous investment compression, the government then retorted that fiscal stabilisation was of paramount importance, even if it meant slow growth. Indeed, that year, the economy registered negative industrial growth. At that time, the government also promised that as part of the structural adjustment process, non-plan expenditure would be brought down so that fiscal consolidation would be achieved. But, today, we have a horrendous scenario of neither having growth nor fiscal balance.

Although, to the general public, the virtual good bye to the latter is sought to be justified in terms of reviving growth, the ground reality is that the proposed capital outlay in the budget for 1994-95 is 6 per cent lower than the revised estimate for 1993-94. Considering the likely inflation rate of not less than 10 per cent, in real terms, the proposed investment would be 16 per cent less.

Very much like in 1993-94, this year too the finance minister has gambled on further lowering of the customs duty, rationalisation of excise duty and reduction in the corporate rate of tax. On excise, the impact of the rationalisation exercise is likely to be increased incidence for majority of the industries that would inevitably push up the cost of production. Customs duty reduction will only act as a dampener on growth of domestic industry. Lowering of the minimum lending rate by just about 1 per cent will be far from being a stimulus. Together with increase in administered prices of petroleum products, railway freight, and foodgrains, the environment is far from being conducive to giving a fillip to growth.

As we enter the fourth year of economic reforms, quite contrary to the expectation originally held out by the reformers that the initial gains would be consolidated within two to three years, the economy has been caught in a bind, with practically no hope for the future. The problem has something to do with the widening gulf between the mandarins in the finance ministry and the rest of the government set-up.

Coming out of the bind would require closing of ranks by the two and synchronising actions.