

| MY VIEW | HETERODOX VIEW

# Budget: managing the fisc while enlarging the growth deficit

Government borrowing is sustainable as long as the rate of return on investment is greater than the interest rate payable



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The Union budget for 2019-20, presented by the finance minister in Parliament last week, is the annual financial statement of the government under Article 112 of the Constitution of India. But the budget speech turned out to be a quinquennial political statement of the government. It showcased the achievements of the past five years and outlined the good intentions for the next five years. In doing so, it reached out to a wide range of constituencies—villages, farmers, women, youth, taxpayers, industry, foreign investors—with political messaging, particularly for the poor. Politics—deft and populist—was in command.

Alas, the problems confronting the economy did not receive sufficient recognition or attention. Gross domestic product (GDP) growth in the fourth quarter of 2018-19 was the lowest in twenty quarters. The investment rate dropped to 29% of GDP during 2014-15 to 2018-19, from 33% during 2011-12 to 2013-14, and 35% in preceding financial years. Exports have stagnated at around \$300 billion in current prices for five years. The unemployment rate is the highest in decades. The budget has done little to revive growth, or investment and exports, both of which are important drivers of economic growth and employment creation.

The irony is that the National Democratic Alliance government walked the supposedly virtuous path of macroeconomic stability between 2014-15 and 2018-19. Fiscal deficits were reduced. Inflation rates were moderate. Ease of doing business was pursued as a priority objective. Commodity prices, particularly crude oil, also remained low. However, the virtuosity did nothing to stimulate private investment or foster growth.

Given this experience, in such an economic slowdown, it would have been logical for the budget to revive growth from the demand side by increasing government expenditure, particularly on public investment. In 2019-20, as compared with 2018-19, total government expenditure as a proportion of GDP remains almost unchanged at 13%, while capital expenditure as a proportion of total expenditure at 12% is lower than the 13% in the previous financial year. Thus, there is no attempt to use government spending or public investment to revive growth.

The basic underlying reason is the objective of keeping the fiscal deficit at 3.3% of GDP. But the magic number of 3% is not sacrosanct. There is nothing in macroeconomics that stipulates an optimum level to which the fiscal deficit must be reduced as a percentage of GDP. Government borrowing is always sustainable if it is used to finance investment and if the rate of return on such investment is greater than the rate of interest payable. The obsessive concern of the ministry of finance,



ANIRUDDHA CHOWDHURY/MINT

mirrored in the media, with the gross fiscal deficit of the central government—as if fiscal deficits of state governments or borrowing by public sector enterprises are irrelevant—is even more baffling.

There is, as always, creative arithmetic in the budget, which underestimates expenditure and overestimates revenue. The outlays provided for sectors or programmes, infrastructure or welfare, simply do not match the ambitious outcomes envisaged in the budget. The revised estimates of revenue receipts for 2018-19, reproduced from the interim budget, significantly exceed the actuals reported by the Controller General of Accounts, which were made public before the budget was presented.

In fact, the shortfall in collection of taxes in 2018-19 was a massive ₹1.67 trillion. Consequently, the 2019-20 budget estimates for gross tax revenue can be realized only if these are almost 20% higher than the actuals in 2018-19, compared with just 8% in 2018-19. That is not all. Non-tax revenue is estimated to rise from ₹2.45 trillion to ₹3.13 trillion, including a whopping 38% increase in dividends and profits from ₹1.19 trillion to ₹1.64 trillion. That is a tall order for dividends from public sector enterprises, unless the Reserve Bank of India pays a very large dividend.

The sale of government shares in public sector enterprises, described as strategic disinvestment, is expected to fetch ₹1.05 trillion. This is portrayed as a reform. In effect, it finances the fiscal deficit, which is defined as the difference between revenue receipts plus non-debt capital receipts (of which 88% are disinvestment receipts) and expenditure. It is clearly not fiscal adjustment,

because it uses asset sales that provide one-time receipts rather than revenue receipts that recur year after year. Given that total budgetary support for capital expenditure is ₹3.38 trillion, disinvestment receipts should be dedicated to retiring public debt or augmenting public investment.

At this juncture, stepping up public investment and government expenditure could have kick-started growth. Through multiplier effects, it could also have provided a stimulus to private investment and private consumption. Allowing the fiscal deficit to widen by 0.5% of GDP would have provided the government with ₹1.06 trillion of additional resources. Given a supporting milieu of macroeconomic stability and low inflation, this could have provided the impetus for driving growth. For a government with a decisive electoral mandate from the people, this first budget was a missed opportunity.

The government has stressed its desire to make India a \$5 trillion economy by 2024. It is a catchy slogan that sounds good. It would feel good only when it improves the well-being of our people. But it is essentially about the arithmetic of compound growth rates. If GDP growth in current prices is 12% per annum (say real GDP growth at 7% and inflation at 5% per annum), and the rupee does not depreciate, India's GDP would rise from \$2.7 trillion to \$5 trillion in just over five years.

A bolder expansionary budget, which raised public investment and allowed the fiscal deficit to be wider by just 0.5% of GDP, would have made this objective easier to attain by fostering growth. Instead, obsessive concerns about the fiscal deficit might now lead to a growth deficit.

## Climate emergency: a dangerous paralysis

The distinction between exhortation and enforcement is fundamental to understanding what governments intend when they announce a policy; and the latest report to parliament of the government's Committee on Climate Change makes it clear that the government's commitment to mitigating the effects of the climate emergency is still very much at the stage of announcing speed limits: targets and exhortations without any enforcement or real effects on behaviour. As a result, there is a smashup coming. A global rise of 4C in mean temperature is equivalent to the entire rise in temperature since the last ice age, and whereas the preceding rise was spread out over 10,000 years, this one will be a compressed into a century.

Of the 25 targets announced last year, one has been met; work on 10 has not even started. The number of civil servants working directly on policy has been slashed since 2013, and central funding for services to help businesses and regions adapt to the coming changes has disappeared. At the same time the problem has grown larger and more urgent... The inaction and frivolity of the state's response is breathtaking. It is now 11 years since the then chief scientific adviser to Defra, Professor Bob Watson, warned about the prospect of a four degree rise, which in those relatively optimistic days looked like a worst case scenario. It is past time to plan seriously and to act on these plans.

*The Guardian*

## US arms sales to Taiwan make strategic sense

The US has agreed to sell \$2 billion in weapons to Taiwan, a move that's consistent with US obligations to the island and yet will still complicate ties with China. While the decision will boost Taiwan's defence, it's also an important statement of US commitment at a time when powerful countervailing winds are blowing. The US should remain resolute in its defence of Taiwan, a signal to China and the region that it remains a force for peace and order in Asia... China protests every sale. Beijing considers Taiwan a rogue province that must be reunited with the mainland. Anything that allows Taipei to deflect Beijing's pressure for reunification is considered interference in Chinese domestic affairs.

More influential on US thinking was the risk that the deal would derail efforts to forge a trade agreement with China and/or undermine US President Donald Trump's attempt to enlist Chinese President Xi Jinping in his project to get North Korean leader Kim Jong Un to abandon his nuclear weapons program. It is to the Trump administration's credit that it has not linked these issues and continues to treat Taiwan as a US interest rather than a pawn in its relationship with China. If this decision helps "normalize" the arms sales process, that is even better.

*The Japan Times*

## Japan-S. Korea flare-up is bad for the region

In a move that the Republic of Korea says risks pushing bilateral ties to a "dead-end street", Japan announced last week that it would tighten curbs on exports to the ROK of three materials vital to the tech industry. Seoul said the measures would leave it with no other choice but to take "countermeasures". Tokyo cited broken trust as reason behind the move, saying there may have been the illegal transfer of sensitive materials from the ROK to the Democratic People's Republic of Korea. But many believe it is Japan's retaliation for recent ROK court rulings ordering Japanese corporations to compensate Koreans used as forced labour during World War II, an issue that Japan insists has long been resolved.

The tough stance that it has taken suggests that Japan no longer wants to continue to bear the moral burden of history-related matters when handling bilateral relations with its East Asian neighbour, especially after the current ROK administration revived the issue of so-called comfort women after its predecessor agreed to a pact in 2015 that was supposed to "finally and irreversibly" resolve the issue... Their dispute puts at risk the good momentum that has been attained in Northeast Asia over the past year or so. China, which has improved relations with both countries, hopes that the two neighbours can resolve their differences through dialogue and consultation. They should focus on their common interests...

*China daily*

## The painfully long road to cash recovery

The federal government has reinitiated its age-old quest for offshore bank accounts. The Federal Board of Revenue (FBR) has empowered the Directorate General of International Tax Operations to go on the latest treasure hunt under Section 230-E of the Income Tax Ordinance, which had been on the books since February... But, legally speaking, FBR officials have said directors can't exercise the powers of commissioners. Then there was the matter of delayed accountability. The PTI [Pakistan Tehreek-e-Insaf] government took four months to issue a simple notification that would have allowed FBR officials to look into foreign accounts using the information provided by the Organisation for Economic Cooperation and Development (OECD)—details of around 152,000 bank accounts with a total of \$7.5 billion in deposits.

The introduction of Section 230-E was also problematic, as it did away with the old international taxation regime without properly empowering the new one... Meanwhile, although the FBR spokesman claims that the commissioners have disposed of a "large number of cases", this newspaper has quoted sources as saying that the directorate could give effect to only one "major" recovery of Rs785 million in Karachi, and even that was many months ago. Overall, only 12 cases have been disposed of. The road to recovery remains painfully long.

*The Express Tribune, Pakistan*

| MY VIEW | PEN DRIVE

# Everyone in Pakistan loves Virat Kohli... I love him too

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Everyone in Pakistan loves Virat Kohli. Almost everyone who follows cricket. That includes those who don't consider Pakistan-India matches anything less than a face-to-face act of war that must culminate in the annihilation of the other. All those who love cricket in Pakistan consider Team India, on merit, a splendid squad. During the Pakistan-India debacle of the 2019 World Cup match on 16 June, there was not a single good bit of Indian cricket that went unpraised by Pakistani cricket enthusiasts. Pakistan, despite defeat, lauded India's performance.

Cricket acts as a noisy catharsis for the best and the most noxious on both sides of the border, highlighting, uneasily, the very real simmering enmity between the two countries which are geographically so close that borders blur in some places.

Pakistan seemed jubilant at the abysmal World Cup departure of the Kohli-led Indian team. In what would have been a normal reaction from a Pakistan that at present, for reasons beyond cricket, doesn't think of

India in glowing terms, instantly noticeable was Pakistani elation at India's defeat, having faced incessant trolling that went beyond good-spirited mockery. It was a predictable response to the defeat of the neighbour-you-love-to-hate. The arrogance of Indians, and not the performance of the team, is what undid India's World Cup.

Watching online reactions, I realized the significance of the shift in the Pakistan-India relationship. It happened after Balakot and Abhinandan. For once, India was everything that Pakistan should distance itself from. No longer was love for Indian movies, songs, actors and cricket distinguishable from venom-spewing politicians and wishing-for-Pakistan's-annihilation public, online and on the streets of India. Pakistanis who always wished to see India as a visa-less journey became aware of the barbs that didn't merely cover wires on borders, but laid the words and sentiments of every Pakistan-bashing Indian seen at political rallies and on TV debates. Voices of the moderates, muffled, became a cave echo that went unheard.

Pakistan believes India does not wish to have peace with Pakistan and that Pakistan should lock its peace overtures in the box of things-that-never-happen.

India does not like Pakistan and Pakistan does not like India. The perception that exists vis-à-vis India in Pakistan and vice versa barely covers the way a regular Pakistani views India. I can't speak for Indians, but I know many Pakistanis who despite being a minority, beyond politics and secure borders, understand the inevitability of a good mutually beneficial relationship.

There is a Pakistani-British doctor who says, "India's medicine and media are very advanced. Pakistan army is the best. India is huge and its education system is superior to ours. I've seen Indian doctors in the UK, how hard they work. Their focus is on their children's education. They spend less on luxury, unlike us!"

There is a businessman who says, "From religious and political angles, India seems to have gone through an upheaval in the last five-six years or so. To me, it seems 1,000 years of Muslim rule has not been digested. Culturally, India is diverse... I still believe the majority of Indi-

ans, like us, want peace and friendship, and are not haters."

There is a high-level diplomat who says, "Hindutva is a vindication of the two-nation theory. Pakistan desires peace, but not if it means capitulation. The Indian tendency to politicize sports and showbiz is deeply resented in Pakistan. India's knee-jerk reactions to terrorist attacks and blaming Pakistan are not taken well in Pakistan. While we recognize that India is bigger in size and resources, we don't want to capitulate to it. For dispute resolution, India, being the bigger entity, has to show large-heartedness."

There is a celebrated female novelist who says, "I've always been fascinated with India because it's our neighbour. We still have a strong association despite the political instability. We share history with India. I love Bollywood movies and that's one of the strongest reasons why I like India... Indians are warm, welcoming. I've received more love and adulation from my Indian

readers than from my Pakistani readers. India and Pakistan can be really good friends if there's no political tension between them."

There is a barrister who says, "I think India is a beautiful country, and I wish we could have good ties with India."

There is a Singapore-based engineer who says, "As India stands today, I see it moving away from its claimed secularism, becoming more intolerant. If it avoids that, it [could be] a big economic power."

There is a Canada-based businesswoman who says, "I've always been pro-India due to its diversity and secularism, but unfortunately, the present India... is losing its diversity and secularism. Minorities are not safe in present-day India. [Yet] I feel Bollywood is equally mine, as if all Indian stars are mine!"

There is a TV presenter who says, "Geographically, economically, India has its own importance. India is our neighbour; it's moving towards becoming a huge world power; but in the context of social and political terms, India doesn't seem like a big power. Its caste and class system, persecution of minorities. All that deprives India of its 'Shining' credentials."

And me... I love Virat Kohli too.

**Despite the mutual dislike, many Pakistanis understand the inevitability of mutually beneficial ties**