

Budget 2007: Bad politics, farcical economics

By

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As the Finance Minister, Mr. P C Chidambaram said after the budget – good economics is good politics. I would add that good politics is good economics. The tragedy is that Budget 2007 is bad politics. The farce is to call it good economics.

First, the politics. Two state elections were lost, both by handy margins, and both reversals from before. Somewhat ironic, but also a reality call on the confused arrogance of the Congress party. Ever since their surprise victory in 2004, the Congress has been ramming down people's throats as to how they were brought into power because of their appeal for the aam aadmi. India shining was for the BJP and the birds, which is why the saviors from Congress were recalled. We were told that the election manifesto, the Common Minimum Programme, was the *raison d'être* for Congress winning, and therefore it was imperative that its populist schemes be adhered to. Not the economic reforms introduced by Manmohan Singh in 1991-1993 and continued by every government since. Privatization was a no-no as were SEZs. The latter was gouging the rural farmers and the former was gouging the common man.

The government had gone in for every populist programme known to Indira Gandhi or Hugo Chavez, the President of Venezuela and the current number one champion in the demagogue populist sweepstakes. Reservations for the OBCs, and for the creamy layer, even if not constitutional, employment guarantee programs, education for the masses, higher taxes for the rich to pay for this populism and so on. The rich and the middle class were only a tiny fraction of the population, and didn't matter either economically, or morally, or politically.

The election results were out a day before the Budget, and if one believed that the aam aurat approved of all the economic populism, one believed in a thumping Congress win. But the Congress was routed leaving one with the following conclusion: maybe good economics of the Congress 1991-96 made them lose, maybe good economics of the NDA made them lose, but now we have proof positive that bad economics of the UPA, 2004-2007 made them lose as well.

The strategy of the Congress coming into the budget should have been for reforms. It was a win-win situation for continuing with reforms. If the election results were to turn out positive, then there was no downside. If negative, then there wasn't anything left to lose. Instead, revealing bankruptcy, the Budget went for...What is not clear, since neither economic nor political objectives were met by the budget.

Inflation and the Budget

Inflation is the number one concern for the economy, so it is revealing to see what the Finance Minister has done to bring down inflation. There are short run policies, and longer run remedies. Before making prescriptions, it is critical to get the facts right. This is the first stage in the battle. And what are the facts on inflation? First and foremost, that

wheat, pulse and edible oil prices are up, and sugar prices down. But wait – that should be modified to that the prices were up. Wheat prices have stabilized, and declining. Sugar is 10 percent below its Sept. level; and price of pulses has declined by a few percent since end September. Acreage for wheat is also up some 15 to 20 percent over last year, so further supply, and decline in prices, is very likely.

Yet another inflation fact is that WPI inflation over the last six months, since end June 2006, has averaged between 4 and 5 percent. In other words the 7 % inflation that the media is talking about (and when it suits them, the government) is a myth. True, inflation did accelerate to above 5 percent, but did so in response to supply shocks that occurred in the first half of last year. That is history, and there is little need, or sense, in designing policies on Feb. 28, 2007 for something that happened a year ago. But that is what a desperate government, short of any new economic ideas, but really long on populism and left ideology, does.

The second stage in the fight against inflation is to design appropriate policies. If you were the Finance Minister, what would you do on food inflation? Would you ban futures trading in wheat and pulses, as the FM has done? And why would you do that? Futures trading allows farmers to plan better, and lock in a price for their sales. Futures trading was recommended, and introduced, precisely for this purpose. So why would one ban it in the name of helping the poor, following one's social conscience, or in the name of the CMP? Has anybody in the world ever brought a price down by banning its trade? Do we not know the follies of prohibition?

The other worse than farcical Budget policy to contain inflation is the new policy on cement. Cement prices rose about 5 percent in 2005/6 and are up about 20 percent this fiscal year. The government, the public, the foreign investors, the aam aurat, and every Ram and Shyam has been hollering over the last few years that infrastructure needs to be developed. The government itself, including the Finance Ministry, has set up funds to invest in infrastructure. The Planning Commission has recommended that the share of infrastructure to GDP should increase to 8 % of GDP from about 4 % in 2005/6. Given all of this recommended increase, and a GDP growth above 8.5 % for the last four years, is it not normal that the relative price of cement go up?

But a price increase in cement does feed into overall inflation. And it may be the case that some cement manufacturers are gouging the poor rich public. Duties and excise tax together add up to 27 percent of the producer price of cement. Given the surplus of tax revenues, and the concern about inflation, could the government not decrease excise duties on cement? Or decrease import duties on cement if domestic cement manufacturers were getting out of line?

Bad politics or confused ideology?

The usual response of the UPA government to every piece of bad legislation it introduces, or bad economic policy it implements, is to say that the Left support is making them do it. This is arrogance at its worst because it all so glibly assumes that everyone they are talking to is stupid. In a different era, it was called demagoguery. Why it is manifestly so is for two important reasons. First, that the left government in West Bengal is possibly the most reformist in India today. So what is good for the left goose there, should be good for the ostensibly not so left gander at the Centre. Second, and most importantly, it is now abundantly clear that Ms. Sonia Gandhi, and her advisers, are about as left as

they come – perhaps even more left than Mrs. Indira Gandhi. It would be a lot better for economic and political policy in India if the Congress were to be public about its worst kept secret – the populist nature of Ms. Sonia Gandhi. True democracy demands that one be open with the public and not hide behind false pretences. In any case, globalization and the information age makes it very difficult to fool the people even some of the time. The Congress, and Ms. Sonia Gandhi, should move forward and admit to their true ideology and agenda – if the people like it, they will vote for you. If they don't, they will boot you out. Isn't that how it should be? Isn't that how it is?

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