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The UPA Regime and Economic Policy

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The defeat of the NDA in the May 2004 elections was a source of consternation in international financial circles. The *Wall Street Journal* even asked editorially: "Why should developing countries like India have such frequent elections?" And it went on to add that if a country like India does have elections, then surely the outcome can not be left entirely to the Indian people; "foreign investors" too must have a say since they have a "stake" in the Indian economy. Similar views were aired in public and private in Washington DC among the Fund-Bank staff and among the financial bureaucracy and the "financial class" within India. Nerves were soothed only when it became clear that policy-making, at least in economic matters, would be entrusted to three persons who had been closely associated with the induction of "neo-liberal" policies, namely Dr Manmohan Singh, Mr Chidambaram and Mr Ahluwalia. Even so, Mr Chidambaram had to miss the first session of Parliament for some days during which he made a trip to Mumbai to reassure the leading lights of the stock-market regarding the new government's adherence to the "liberaliz-ation" agenda.

It is important to understand the reasons behind the financial circles' consternation. On several issues ranging from Employment Guarantee to disinvestment in PSUs, to social sector expenditure, the Congress Party's Manifesto, many of whose proposals subsequently found their way into the National Common Minimum Programme, had a thrust very different from that of the "liberalization" agenda. Perceiving the popular mood, it envisaged a more active role for the State in promoting employment and welfare. And *this* is anathema for international finance capital which is interested *not in a "retreat of the State", as is often claimed, but in a transformation of the State into an instrument for promoting its own exclusive interests.*

The reason for its opposition to State activism in matters of employment and relief for the people however lies not just in its *preference* for a different, and from its point of view "better", State. It opposes such "State activism" for two other basic reasons. First, such activism destroys its own social legitimacy. Even capitalists engaged in production, who stand to gain, by way of larger profits, from the boost to economic activity that comes from larger State investment, invariably oppose the existence of a public sector (they want public ownership of any profitable unit to be only a transient phenomenon), because it undermines their legitimacy: if it becomes clear that the

State too can run enterprises, then a class of capitalists, whose necessity is supposed to lie specifically in their exclusive ability to perform this task, becomes palpably superfluous. This fear is even greater for *finance capital*, which essentially represents *rentier* interests, with very little involvement in production, and which therefore sustains, in Lenin's words, a class of "coupon-clipping" "parasites". The absurd myth that the state of the stock-market determines the pace of accumulation and hence the vigour of a capitalist economy, and the conclusion that everything must be done to keep the stock-market buoyant even to achieve social goals, which finance capital so self-servingly promotes through its various mouthpieces including the media, will cease to be sustainable if the State steps in for providing employment and relief. Finance capital therefore opposes such State activism at all costs.

Secondly, the rolling back of *dirigisme* has the added advantage, from the point of view of finance capital, that it unleashes a process of "primitive accumulation" of capital through the privatization "for a song" of public enterprises. On the other hand if the State were to be more active in providing employment and relief to the people, then not only would this bonanza be denied, but there might even be heavier taxation of capitalists.

MODUS OPERANDI OF DEFLATION: FRBM ACT

The *modus operandi* of imposing expenditure cuts on the government is through legislation such as the Fiscal Responsibility and Budgetary Management Act, which had been passed under the NDA government, and which the UPA government promptly owned upon assuming office, even though the Act constitutes an extraordinarily irrational piece of legislation. The Act provides for a reduction, in a manner stipulated by itself, in the magnitude of the fiscal deficit to a ceiling of 3 per cent of GDP. When there is no legislation stipulating the minimum tax-GDP ratio, when there is no legislation stipulating the minimum ratio of social sector expenditure to GDP, when there is no legislation stipulating the minimum expenditure on anti-poverty programmes to GDP, why there should be a law that stipulates the maximum ratio of fiscal deficit to GDP is baffling to start with, *when there is absolutely no theoretical reason to believe that a fiscal deficit is necessarily harmful*. Matters become even more bizarre when it is recalled that this ratio is supposed to hold good *under all circumstances*, whether there is a recession or not, whether there is a collapse of employment or not, whether there is massive poverty or not. And the bizarreness only increases when it is recalled that *a rise in the fiscal deficit does not necessarily mean a rise in the government's net borrowing.*

Consider a simple example. Suppose the government borrows from the banking system Rs 100 to spend on an employment generation programme. Let us also assume for simplicity that the only commodity for which demand is generated through the expenditure on such a programme is foodgrains. If there are plenty of foodgrain stocks in the economy rotting in the godowns even as people go hungry owing to lack of purchasing power, *then it would be plain stupid, indeed criminal, on the part of the government, not to undertake this expenditure because the fiscal deficit would increase thereby.* But the stupidity in such a case is even greater than appears at first sight. The Rs 100 spent on the programme would accrue back to the FCI which holds the foodgrain stocks, which itself is a government-owned entity. The FCI may use the money to repay its bank loans by Rs 100. In this case what the government's right hand (i.e. the budget) has borrowed from banks is paid by its left hand (the FCI), with no increase in the government's net indebtedness to banks. Indeed if FCI transactions figured as part of the budget, as they used to do till the early seventies, then the fiscal deficit in the budget itself would have shown no increase. But the mere convention of not showing FCI transactions in the budget would mean that government expenditure on such an employment programme through borrowing from the banks would be disallowed under the FRBM Act. This Act therefore prevents the government from increasing demand in the economy, *including demand in the public sector even when this sector is saddled with unutilized capacity and unemployment.* It ensures *both* an eschewing of State activism for undertaking investment, and providing employment and relief (and hence an unrolling of red carpet for MNCs to undertake investment in lieu of the State, even through offers of guaranteed rates of return in foreign exchange), *and* the perpetuation of "sickness" in the public sector units which then is used as an excuse to "privatize" them for a song. Professor Joan Robinson, one of the outstanding progressive economists of the twentieth century, called this self-serving argument of finance capital against fiscal deficits the "humbug of finance". The UPA is officially as committed to this "humbug" as the NDA was, though under the force of the circumstances it has both postponed the target date for reaching the ceilings specified under the FRBM Act, and used several subterfuges to get around its stringency, as we shall see later in the context of the 2005–06 budget.

While the considerations underlying finance capital's promotion of "liberalization" and the resulting transformation in the nature of the State are thus quite obvious, its being "international" gives the efforts of finance capital a spontaneous effectiveness. Any State that refuses to transform itself into a servitor of financial interests would find itself faced with a flight of finance from its economy, *unless it imposes controls on the free movements of capital into and out of its shores, i.e. unless it reverses the "liberalization agenda" and sets up an alternative dialectic to that of "liberalization".* It follows that the so-called “liberalization with a human face” is a contradiction in terms. If a “human face” is to be put on the development process, through the provision of employment and relief by the State, then willy-nilly the process of “liberalization” has to be reversed; on the other hand if the process of “liberalization” is persisted with, then one can forget about the “human face”.

International finance capital is instinctively aware of this. And that is why when the UPA government came to power, it was stunned for a while, especially since the dependence of the government on Left support meant that it could not make a simple about turn with impunity on the NCMP. There is in short a fundamental opposition between the interests of the people and the interests of international finance capital and the domestic big bourgeois and financial class aligned to it. The entire period since the UPA came to power has been a period of intense struggle arising from this opposition. While appeasing financial interests and soothing the nerves of international financial capital, the government has not been able to push ahead with the “liberalization” agenda to the extent it would have liked; it has faced stiff opposition at every step from the Left on whose support it depends for its survival. At the same time it has reneged on every one of the major promises made in the NCMP, with the Left mounting intense pressure against such reneging. Some of the critical areas of such struggle are highlighted below.

THE EMPLOYMENT GUARANTEE SCHEME

Perhaps the most striking provision of the NCMP was the scheme for giving 100 days of assured employment to one member in every rural household. This itself was a comedown from the Congress Party’s election promise of giving 100 days of assured employment to one member from each household, *both urban and rural*. The idea of assuring employment to only one member per rural household was obviously discriminatory against women; and in any case the scheme promised only paltry relief, since only 100 days of assured employment per household did not amount to much. Even so, the scheme was important in the context of the sharp deterioration in the living conditions, including per capita food absorption, of the rural poor, which had come about through the drastic curtailment in rural purchasing power arising inter alia from the cutback in rural development expenditure of the government. This cutback in turn was a consequence of the reduced tax revenue and the compressed fiscal deficit that neo-liberal policies had engendered.

From the very beginning however the scheme aroused fierce opposition, first in the name of a resource constraint, and subsequently, when even the Planning Commission found that the total expenditure for running such a scheme would be no more than Rs

25,000 crores annually at present, which is no more than 1 per cent of the GDP, in the name of administrative difficulties. When even this failed to carry conviction, the opposition to the scheme took up the familiar refrain: “why waste money providing what in effect would be a dole when that money could be better used for increasing the growth rate and providing more meaningful productive employment through that route?” It was conveniently forgotten that if high growth *could* provide more productive employment in adequate quantities, then the very fact of rural distress and the need for an employment guarantee scheme would not have arisen in the first place.

The real objection to the EGS was the fact that it went against entire thrust of neo-liberalism, promoted by international finance capital, of rolling back State activism in matters of employment and relief for the people. And this objection was reflected in the Draft Bill that was presented to the Parliament. The Draft replicates the basic flaw inherent in the original NCMP provision itself, namely, that by taking the household as the unit it ignores the claims of all individual adults for employment guarantee, and thereby also implicitly discriminates against women. In addition however the Draft reneges on the NCMP itself in at least three crucial ways: first, it does not provide for the extension of the scheme to cover the entire country within a specified period of time; secondly, even in areas where it is to be introduced the Draft allows the government to withdraw the scheme at will; and thirdly, the scheme according to the Draft is supposed to be targeted towards “poor households”, which is a clear violation of the NCMP promise of a *universal* employment guarantee that is so essential, both because of the gross underestimation of poverty and the woefully inadequate identification of the “poor”, and because universality confers a right and is therefore a means of empowerment of the working masses. In addition, the Draft does not ensure employment at the statutory minimum wage, and, by insisting on a narrow definition of “productive work”, effectively ensures that most people covered under it would be entitled at best to some unemployment insurance which would be no more than a pittance. In short, instead of the significant action on the employment front, notwithstanding all limitations, that was envisaged in the NCMP, what we have is a damp squib.

The Draft is before the Standing Committee, and the coming days will see an intense struggle between the democratic and progressive forces on the one hand pressing for a worthwhile EGS, and a recalcitrant government on the other resisting this pressure. Afraid to alienate finance capital, the government may attempt to split the progressive forces by demanding a price for a larger EGS in the form of cutting some other relief expenditure; and, if pushed, it may even consider associating the World Bank and other such organizations in the financing of it. Since these organizations typically demand their “pound of flesh” for such financing and then quietly drop the scheme after having obtained this “pound of flesh”, associating them would mean not a departure from the “liberaliz-ation” agenda but, on the contrary, an active promotion of it under the false pretense of introducing a “human face”.

THE FINANCIAL SECTOR

A second area of struggle has been the financial sector. A precondition for any relief to the people, it follows from the foregoing, is control over financial flows, which obviates the need for pursuing policies catering to the caprices of finance. The Left has been asking for such controls for a long time. But matters have come to such a pass, with foreign exchange reserves crossing $140 billion, and as much as $10 billion being added in the mere space of four weeks ending March 11, that even the Governor of the Reserve Bank of India asked for some checks on financial inflows, which, as he had expressed it once earlier, were using India “as a parking place for dollars”. Within minutes of his having asked for such checks, he was asked by the Finance Minister to eat his words, which he duly did at a hurriedly-convened Press Conference rather late at night. In short, the government is adamant on maintaining liberal financial flows into and out of the country, and this is extracting a heavy price from the economy, apart from precluding any relief for the people owing to the constant need to retain speculators’ “confidence”.

This heavy price is because of the fact that while the country hardly gets any return on these reserves (the average rate of return is supposed to be around 1.5 per cent), those whose inflows have contributed to these reserves are getting huge returns (inclusive of capital gains), well over 20 per cent, on the funds they have brought in. Since holding reserves is analogous to lending abroad (since it entails holding “IOU”s of foreign governments and banks) the country in effect is borrowing dear to lend cheap which is both silly as well as ominous for the future. On the other hand, not holding these reserves would make the rupee appreciate in the face of such inflows, which would mean a de-industrialization of the economy *paid for by short-term borrowing.* If for instance $100 flow in, then, if reserves are not held, the rupee would appreciate until a current account deficit of $100 has been created through an increase in imports at the expense of domestic output; this would mean a shrinking of domestic activity and unemployment. The country’s debt in other words would have increased in order to finance its own ruin through de-industrializ-ation, or it would have experienced what one can call a “debt-financed de-industrialization”. If this is to be avoided, as well as the silly and ominous piling up of reserves, then the only way is to control financial inflows, which are being used *entirely for speculative purposes.* The

RBI governor, by no means a radical or Leftist, had suggested just this. The government obviously however has no intention of getting off this perilous course.

Indeed on the contrary it is attempting two further steps which are exceedingly dangerous: the first is to move ahead towards capital account convertibility, and the second is to push financial liberalization even further so that the economy gets even more closely enmeshed in the vortex of globalized finance. A whole series of measures, such as merging public sector banks; enlarging the equity base of the public sector banks, apparently for satisfying the "Basle norms", through attracting private holders; allowing foreign banks to take over private sector banks; the shift away from development banking; the permission given to specialized development finance institutions (IDBI being the latest example) to start banking operations; the permission given to banks to operate on stock exchanges and commodity exchanges; the tolerance shown to banks which flout priority sector lending norms; and indeed the attempt to cover up banks' transgressions in this regard by expanding the definition of "priority sector"; are but a few illustrations of the government's determination to detach the financial sector in India from its obligation to serve the needs of the productive national economy, and to make it instead an integral part of the world of international finance.

This effort of course has been on for some time. The goal of social and developmental banking has been receding into the background, and this, as is well-known, has already had disastrous implications in the case of the agricultural sector. The share of agriculture in total bank credit (both direct and indirect) which stood at 15.9 per cent in March 1990, has declined steadily to a low of 9.9 per cent a decade later. The peasants have had to turn to moneylenders charging exorbitant interest rates, and the debt-trap closing in on them has typically been the immediate provocation for peasant suicides.

The era of planning and of the pursuit of a strategy of relatively autonomous capitalist development had seen a transformation of the financial sector in India from serving the needs of a colonial economy and of a few monopoly houses that had developed in the interstices of the colonial economy (especially after the grant of "discriminating protection" in the twenties and thirties) to facilitating accelerated and a broader-based capitalist development, including in agriculture through the "Green Revolution" (after bank nationalization). This transformation, starting with the nationalization of the Imperial Bank of India and the setting up of specialized financial institutions like IDBI, IFCI, ICICI, and SFCs, and ending with the nationalization of large private sector banks, had created the basis for building up the productive base of the economy in all its diversity.

What we are seeing now is yet another transformation. The case for the merger of public sector banks in terms of economies of scale is entirely unfounded. And as for the argument that such merger is necessary to make Indian banks withstand foreign competition in the new environment, it is amusing that this argument is being advanced not by the banks themselves groaning under the impact of some presumed un-competitiveness but by Mr Chidambaram and Finance Ministry bureaucrats, who, day in and day out, preach the virtues of State non-intervention! The real idea behind this merger and allowing foreign banks to take over private Indian banks (that is so at present, but later no doubt they would be allowed to take over public sector banks as well) is to have a limited number of large players, led by foreign banks, in the banking sphere who would then go global, engage in speculative and high profit activities, detach themselves entirely from the "messy" business of lending to a host of peasants and petty producers, and get monopoly control (especially the foreign banks) over the debt of the government (or what is called "sovereign debt") which is a highly prized plum even today as it was in Lenin's time. The result would not only be the end of the era of banks serving the needs of production, but the creation of an ambience where financial crises of the East Asian kind would occur, resulting in a stagnation of the economy and a de-nationalization of its assets.

The Bank Employees are already struggling hard to prevent such a denouement. The Left is aware of the dangers of the course being advocated by the Finance Ministry. The coming months would see intense struggles over these measures.

THE ALIBI OF THE NEED FOR FDI

The case for financial liberalization as a total package is ultimately argued on the grounds of the presumed need for FDI. Prime Minister Manmohan Singh pleaded before a bunch of financiers in New York that unless India got $150 billion FDI over a 15-year period to improve her infrastructure, her economic prospects were bleak. This cringing before metropolitan finance, though it started with the NDA and hence predates the UPA, certainly marks a enormous departure from the earlier days, when Prashanta Chandra Mahalanobis had gone lecturing all over America about how India was embarking on a massive industrialization effort *on her own and with her own resources.* The favourite ploy of our current leaders of course is to cite the example of China which these days gets around $60 billion FDI each year compared to $4 billion of India: the suggestion is made that without such heavy investment China could not achieve her extraordinary growth rates, and that if India wanted such high growth rates then she too would have to woo FDI assiduously.

This argument is wrong on several counts. First, the large influx of FDI is hardly necessary at present for China's remarkable growth performance. China, as is well-known, has massive and growing foreign exchange reserves which are built up out of her own earnings in the form of current account surpluses, and not through speculative financial inflows as in the case of India. She is in other words maintaining an excess of savings over non-FDI-financed investment. Her need for investible resources from outside therefore is correspondingly less. FDI in her case could be a useful means of bringing in technology or of marketing her products, but for these purposes technical collaboration or marketing agreements could do as well. Her reasons for large FDI inflows at present therefore remain obscure. At any rate, inflows on this scale are certainly unnecessary for the maintenance of her growth rate. Secondly, FDI typically flows into those economies which already have high domestic savings rates anyway. It does not constitute a means of compensating for low domestic savings. Since India has a savings rate much lower than in the East and South East Asian countries, and since this rate has not gone up at all during the period of "liberalization", to pin hopes on FDI to provide a way out of this situation is a chimera. Thirdly, in the case of India, as suggested earlier, there is plenty of unutilized capacity, within the public sector itself, which can be used with impunity for boosting public investment through an enlarged fiscal deficit, without even having to raise tax revenue.

In short, FDI is both unnecessary for boosting India's growth rate and unlikely to come in any significant quantities, despite all the blandishments being offered. But since these blandishments include financial liberalization, which necessarily engenders deflation and cut backs in public investment, that in turn have a discouraging effect on private investment, all this wooing of FDI in the name of *stepping up* the investment ratio is paradoxically having the opposite effect of dampening the investment ratio.

The blandishments include an increase in the foreign equity cap in critical sectors. The first UPA budget, for 2004–05, had identified telecom, civil aviation and insurance sectors as the ones in which the level of permissible foreign equity holdings would increase. The FDI cap has already been lifted in the civil aviation sector (from 40 to 49 per cent), and on February 2 the government cleared a proposal to raise the FDI limit in telecom from 49 to 74 per cent. But these precisely are sectors where foreign investment is not only unnecessary but positively harmful. In the case of telecom moreover there are serious security considerations involved in having majority foreign-owned companies. The idea seems more to give foreign capital a finger in the profitable pie that is the Indian market, at a time when metropolitan capital in these sectors is desperately looking for outlets elsewhere, than to bring any benefits to the Indian economy. The Left has been fiercely resisting these measures, but these unfortunately do not need parliamentary approval.

PENSION FUNDS

The latest move of the UPA government to let pension funds be used in the stock-market and pensioners take the risk of loss, is yet another "liberalization" measure with serious consequences for an extremely vulnerable section of the population. But it is not just a matter of how these funds are used. The 2005–06 budget permits the entry of FDI into the pension sector. In effect therefore the government is planning to hand over pension funds to MNCs for the purpose of speculating on the stock-market.

The argument often advanced that the burden on the exchequer on account of pension payment obligations is becoming too heavy is unacceptable. It is the solemn duty of the government to meet whatever burden pension payment obligations impose upon it, and it has to find the resources to fulfill it. Considering the fact that 50 per cent of the pension payment obligations are on account of the armed forces, demurring at discharging this duty is in particularly bad taste.

But then, even some well-meaning observers point out, since the pensioners would be exposed to the possibility not just of losses but of gains as well, they may even end up being much better off from the proposed measure. Why should they object to it? The reasons are simple: first, any person would be the most risk-averse when it is his or her pension funds which are at stake; and secondly, the risks are far greater than usually supposed. They arise not only from the fact that the stock market fluctuates wildly, but also from the fact that the pensioners could well become victims of unscrupulous speculators using their funds.

This last point is often missed: in a country like ours the political empowerment of the people is far greater than their legal empowerment. They have a much better chance of getting redress through political pressure than they have of getting redress through legal action. They are safer when their claims are with the State than they are when these claims are on some private speculators. To leave pensioners to the mercy of a bunch of speculators by allowing the latter to play the market with their funds would be an almost criminal dereliction of duty on the part of the State which the Left has rightly vowed to resist to the bitter end.

THE PATENT AMENDMENT ACT

There are two areas where the government has yielded some ground under pressure from the Left. One is in the area of patents; and the other is the current year's budget. Let us examine these.

India had a Patent system introduced through an Act in 1970 which was highly appreciated by progressive opinion all over the world. Among other things it kept the prices of drugs low, and did so by not recognizing product patents. No patentee in other words could prevent someone else producing the same good using some process other than the one which had been patented. This enabled the domestic production of drugs, which had been developed abroad, by using a different process. Domestic substitutes of drugs developed abroad could therefore be locally produced and sold cheap. The TRIPS agreement under the WTO permitted product patents, and allowed a 20 year life-span for patents compared to the 7 years under the Indian Patents Act 1970. The WTO agreement which was signed without taking the parliament’s prior permission, enjoined on India the obligation to amend her Patents Act to make it TRIPS-compatible.

The WTO agreement however, like all international agreements, has provisions and loopholes which could still be exploited to the benefit of the Indian people while amending the 1970 Act for TRIPS-compatibility. In other words, the term “TRIPS-compatibility” is itself a matter of interpretation, and any government that is concerned with the welfare of the common people, should naturally use an interpretation that safeguards their interests to the maximum extent, even assuming that we have to fall in line over “TRIPS-compatibility”. But the NDA government brought in amendments that showed scant respect for the people’s welfare and passed an ordinance incorporating them. The UPA not only re-issued the ordinance, but proposed an amended Act *that was an exact carbon copy of the NDA’s proposed legislation.* This has been changed under pressure from the Left and the amended Act, though TRIPS-compatible, protects the people much better. To be sure the very introduction of product patents has deleterious consequences, and in that sense *any* amendment of the 1970 Act is retrograde. But *within* the framework of the WTO, the amended Act is much better than the NDA/UPA Draft.

This becomes clear if we take a look at the demands made by a Peoples’ Commission which operated with the aim of getting the most out of the existing TRIPS agreement. Its main demands were as follows:

> (*i*) . . . The term “invention” should be reserved for a “basic novel product or process involving an inventive step and capable of industrial application”. All three criteria, “novelty”, “inventive step” and the quality of being “capable of industrial application”, must be insisted upon. (*ii*) . . . The proposed amendments allow patenting of micro-organisms. This must not happen. Micro-organisms, including viruses, should not be patented, and hence should also figure alongside plants and animals, including seeds, varieties and species, in the list of non-patentable items . . . (*iii*) . . . The proposed amendment provides no scope for compulsory licensing in cases where, notwithstanding the offer of reasonable commercial terms and conditions to the patent holder by an enterprise, the patentee

does not respond within a stipulated period of time. In all such cases compulsory licensing is permitted even within the framework of TRIPS Article 31 (*a*) and (*b*), and countries like Brazil and China have passed legislation allowing compulsory licensing. This omission from the proposed amendment must be remedied forthwith. (*iv*) . . . In all cases where compulsory licenses are granted, even though the production is supposed to be “predominantly” for supply in the domestic market of the country in question, exporting should also be explicitly allowed . . . (*v*) . . . Where applications have been received during the transitional period 1.1.1995 to 31.12.2004, . . . patents, if granted, would be effective from the latter date for a period of twenty years from the date of application. In all such cases if any production activity has been started by any enterprise during the transition period, then that enterprise should be allowed to continue production on payment of a nominal royalty to the patent-holder, after the patent has been granted, instead being accused of violating the patent. (*vi*) . . . The magnitude of royalty payment should be explicitly stipulated within a range, say 4–5 per cent, of the sales turnover at ex-factory price. (*vii*) . . . Since the TRIPS Agreement itself provides no explicit system of examination of any pre-grant opposition to the grant of a patent, the existing provision in the Indian Patents Act 1970, which is being sought to be amended, should be retained.

It is noteworthy that all these suggestions, barring (*ii*) and (*vi*) were incorporated in the amended draft of the Act owing to the Left’s insistence, and that (*ii*) has been referred to an experts’ committee. At the same time however the necessity for mobilizing public opinion in favour of a re-negotiation of the WTO, including in particular the TRIPS agreement, remains. Unless a strong public opinion is built up the correlation of political forces cannot be changed to a point where we can either reject or go beyond the existing framework of the TRIPS agreement.

THE 2005–06 BUDGET

The 2005–06 budget differed from other recent budgets both in its rhetoric and in the somewhat larger allocations it made for social sectors and rural development, including employment generation. The absolute amounts involved of course were still very small, and even these small provisions may not materialize if on account of tax shortfalls, which are bound to arise this year, as they did last year, owing to the significant overestimation of tax receipts in the budget, the Fiscal responsibility and Budgetary Management Act comes into play and expenditures have to be scaled down. Even so, the change is noteworthy.

This change however does not signify any shift away from the neo-liberal package of policies. On the contrary many of its suggestions like opening up the mining and pension sectors to foreign direct investment, encouraging crop diversification at the expense of foodgrain self-sufficiency, the reductions in customs duties on a range of capital goods, and the cut in corporate income tax rate from 35 to 30 per cent on domestic capitalists, are all measures emanating from the neo-liberal perspective. And when one adds to this the pronouncements of the *Economic Survey* on capital account convertibility and on “labour market reform” (which means in effect the institutionalization of the right to retrench), it is clear that no change of direction away from neo-liberalism is being contemplated.

Two questions immediately arise. First, how is it that within a regime committed to neo-liberalism, additional *financial* resources have been found for rural development and social sectors? The Finance Minister appears to have given out substantial tax concessions all around and yet managed to increase the Gross Budget Support for the Plan by 16.9 per cent over the previous year (BE to BE) and the Budget Support for the Central Plan by 25.6 per cent, even while ensuring a marginal reduction in the fiscal deficit to 4.3 per cent of the GDP. For a government that till the other day kept asking “Where is the money?” when any worthwhile proposal was mooted, including a universal EGA, this is a remarkable turnaround. How has this become possible? Secondly, does the fact that the government has made larger provision for rural development and social sectors while remaining committed to a neo-liberal course suggest that we have finally arrived at “liberalization with a human face”, contradicting the claim made above that the two cannot go together? Let us discuss these *seriatim*.

The answer to the first question, about the source of financial resources, is simple: the budget manages to balance its figures through substantial “window dressing”, both in the matter of the expected tax revenue and in the matter of the expected fiscal deficit.

With the reduction in corporate tax rate, with the removal of a large number of service providers from the purview of the service tax, with the lightening of the income tax burden, with the reduction in customs duties on a large number of items, especially capital goods, and with significant concessions in the excise duties on several items, the Finance Minister’s claim that his indirect tax proposals would be broadly revenue neutral and that his direct tax proposals would garner Rs 6000 cr. extra, appears untenable, notwithstanding the 50 paise cess on petrol and diesel, and the slightly heavier taxation on “health hazard” goods. But even if his claim is accepted, the tax revenue calculations still appear grossly unrealistic. If we assume a generous 9 per cent growth in real terms of the non-agricultural sector during 2005–06, and a 6 per cent rate of inflation, the nominal growth rate of this sector comes to 15 per cent. At existing tax rates the tax revenue cannot be expected to increase at a rate much higher than this. And if additional tax revenue mobilization is a small Rs 6,000 cr., it follows that *total* tax revenue should also increase at around 15 per cent. Instead we find an expected tax revenue increase, compared to 2004–05 (RE), of 21 per cent, clearly an overestimate. This would not matter if the Finance Minister chooses not to be tied down by the FRBM, a silly piece of legislation as we have seen; but if he does, then the positive features of the budget would be undermined.

The second area of “window-dressing” is with reference to the fiscal deficit. There is a substantial “off-loading” of borrowing from the budget to off-budget entities. At least three deserve mention. The first is State governments. The Budget documents show what at first glance appears a rather surprising *reduction* in total capital expenditure, and correspondingly in the Gross Budgetary Support for the Plan. Plan Expenditure for instance falls from Rs 145,590 cr. last year to Rs 143,497 cr. this year (BE to BE). The Finance Minister however claimed that the Gross Budgetary Support (on a comparable definition to what was used earlier) would be Rs 172,500 cr. for 2005–06. The reason for this discrepancy lies in the fact that following the Twelfth Finance Commission’s report, State governments would be borrowing around Rs 29,000 cr. for their Plans from the market. Earlier the Centre would have borrowed this amount and handed it to the States, but now the States themselves would have to go the market.

This represents an offloading of the fiscal deficit from the Centre to the States. In addition it is fraught with potentially serious consequences. States may not be able to get the loans on reasonable terms, especially in these financially “liberal” times (when even the captive market for government and government-approved securities provided by the Statutory Liquidity Ratio is being abandoned according to this year’s budget); some States may not be able to raise their loan requirements from the market at all. True, the Centre which earlier had the sole prerogative of market borrowing charged the States exorbitant rates on the loans it provided to them; but the solution to that lies in regulating the rate at which the Centre can lend to the States (pegging it for instance at certain fixed percentage points below the average nominal growth rate of the GDP) rather than having the States borrow directly from the market which could even be a prelude to the fracturing of the nation’s unity (if States started borrowing freely from *international* agencies).

The second instance of implicit off-loading of the fiscal deficit is with regard to the Infrastructure Development Fund, whose capital of Rs 10,000 cr., which is supposed to provide “bridge finance” for infrastructure projects that are remunerative economically but not financially, is not provided for in the budget. Instead of borrowing directly, the government, in other words, is making an agency set up by itself do the borrowing. This borrowing, being off-budget, is not shown as part of the fiscal deficit.

The third instance is the absence of any reference to the food component of the Employment Programmes in the budget documents. The 5 million tonnes which the Finance Minister has promised as the food component of the Food For Work programme and which does not figure in the budget will obviously be loaned by the FCI to the FFW programme. A part of the fiscal deficit is thus shifted out of the budget by making the FFW borrow from the FCI instead of getting funds from the government which would have had to borrow for the purpose.

For these reasons the actual fiscal deficit generated by the budgetary provisions is much larger than what appears in the documents. One cannot fault this in principle. On the contrary it only confirms the point that the FRBM Act which forces the government to do such “off-loading” of the fiscal deficit away from the budget to other government organizations is a nuisance which even people like Mr Chidambaram have come to realize.

But it is more than a nuisance. The practice of “off-loading” which it implicitly encourages can have positively harmful implications. For instance, such “off-loading” may, *given the general neo-liberal ethos*, jeopardize the future of the agencies on to whose shoulders the deficit is being off-loaded: State governments, as already mentioned, might turn into proteges of agencies like the ADB and the World Bank (which some of them are already in the process of becoming) under these circumstances. This could damage the integrity of the nation. Likewise if the FCI’s giving loans to the FFW programme increases its own deficit (which is covered through the food subsidy), then in the name of cutting the food subsidy the same government might decide to wind up the FCI. In other words, enlarging the fiscal deficit whether directly through the budget or through other government agencies is fine provided *a consistent approach of defending the government agencies is simultaneously adopted.*. But, one cannot be sure of this.

Besides, while enlarging the fiscal deficit for incurring larger expenditure is perfectly legitimate in a demand-constrained system, there is little justification for doing so *together with a reduction in corporate income taxation.* The argument that some parity has to be established between personal income taxation and corporate income taxation has no basis whatsoever. Hence the argument that since the highest rate of personal income tax is 30 per cent, the rate of corporate income tax must also be reduced to 30 per cent from the current 35 per cent lacks substance.

Indeed most of the tax concessions given in the budget lack any justification. There is no reason why the scope of the service tax should be cut down from its existing level. There is no reason why import duties should be reduced on a variety of capital goods: while it would have a scarcely noticeable effect on the overall investment, it would act to the detriment of the domestic capital goods producers, causing a degree of de-industrialization in this sector, which would also follow from the de-reservation of a number of items hitherto reserved for the small-scale sector. Likewise, there is also no reason for reducing the excise duties on a variety of luxury goods like air-conditioners. And the reduction in import tariffs on a range of agricultural goods is precisely the opposite of what the government should be doing if it wished to undo the damage done to this sector by neo-liberalism. Even experts like M.S. Swaminathan have been arguing that agriculture cannot be treated like any other sector in the matter of protection, since the livelihood of millions of peasants and labourers who have nowhere else to go depends upon it. The budget alas pays scant heed to such sage advice.

While these tax concessions are being given, the imposition of a cess of 50 paise per litre on petrol and diesel appears uncalled for, especially as it comes on top of price-hikes decreed very recently on these commodities. The relief which the budget provides by way of reductions in import and excise duties on kerosene and LPG would be offset to an extent by this cess. In the case of petrol the net revenue raising effect is much less than what appears at first sight since the government is a major consumer of the commodity. In the case of diesel, any price hike jacks up transport costs and has an across-the-board inflationary impact which should have been avoided.

Two suggestions thrown out in the budget are a source of disquiet. The first relates to the banking sector where the bounds on the Statutory Liquidity Ratio and the Cash Reserve Ratio are sought to be removed and the Reserve Bank made free to prescribe such prudential norms as it deems fit. This entails giving greater autonomy to the RBI and making banks free in their portfolio choice which would enable them to speculate more freely. Both these, like the earlier pronouncement regarding making the management of public sector banks more autonomous, are measures of financial liberalization which would have adverse consequences for the economy. The Finance Minister who talks of giving more credit to agriculture in one breath, cannot advocate financial liberalization in the next without inviting the charge of not being serious about the former objective.

The second disquieting suggestion relates to the entry of foreign direct investment into mining and pension funds. The case of pension funds we have already examined above. As regards mining, the argument against FDI is obvious. Indeed, as Joan Robinson, the well-known Cambridge economist mentioned earlier, had once remarked, of all the different areas of FDI involvement, the mining sector is the worst, since minerals are an exhaustible resource. The MNCs extract the mineral, ship the surplus back home, and leave when the mine gets exhausted. But when that happens, the country is left high and dry, with no more mineral resource left. The case of Myanmar illustrates the point. At one time its oil wealth attracted much foreign investment (Burma-Shell), and it experienced for a brief period an enormous boom, when oil extraction was going on. But today, with its oil wealth exhausted, it is one of the forty "least developed" countries in the world. There is absolutely no argument whatsoever for inducting MNCs into the mining sector.

This brings us to our second question: is the budget an embodiment of "liberalization with a human face"? The fact that patently neo-liberal measures are being contemplated by a Finance Minister who has ostensibly shown concern for the poor, only demonstrates that this budget is an attempt to please all, the MNcs, the corporate sector, the salariat and, to an extent the poor and those who speak for them. Such a "please-all" budget can only be based on a degree of arithmetical jugglery and hence can only be a transitory phenomenon. Or putting it differently, this budget does not mark the ushering in of a "growth-with-equity" trajectory, or of "liberalization with a human face". It rather represents a temporary tactical compromise, a tactical adjustment in the march along a neo-liberal path, which has been necessitated by the relentless pressure exerted on the "liberalizers" by the Left.

CONCLUDING OBSERVATIONS

The last few months of the functioning of the UPA government reveal clearly the bind in which it is caught. It cannot openly discard the Common Minimum Programme to which it is ostensibly committed; it cannot push ahead with impunity with the neo-liberal programme which international finance capital enjoins upon it. Its attempts to browbeat the Left to allow it to discard the CMP for a neo-liberal programme have failed. Some bourgeois commentators, impatient with this situation, have even started flying kites about a "grand coalition" between the Congress and the BJP, which in effect means a "grand coalition" between sections drawn from both these Parties. What these commentators fail to understand is that even if such a grand coalition were to come about, which is a tall order anyway, it would not get the mandate of the people who have expressed their rejection of neo-liberal policies in the May 2004 elections. The bind of the government is really the outward manifestation of an interregnum, a stand-off between the forces aligned to international finance capital on the one hand and the popular forces on the other. As the latter become more organized, conscious and effective, the present situation would change in a more favourable direction for the progressive movement.