

Alternative economic policies for India based on analysis of the alternative budget

Shruti Vats

Assistant Professor Aryabhata College, University of Delhi, New Delhi, Delhi, India

Abstract

With rising debt and interest burden there was a need for a change in fiscal policy change In the Indian economy. This paper shows the possibility of an alternative change to the IMF dictated budget adopted at that time. A comparison has been made between four scenarios. Scenario I has been drawn up to show the 1994-95 budget if the country would have been persisted with the observed trends of 80s. Scenario II are the projected estimates for 1994-95 if IMF dictated policies are followed. A comparison between the revised estimates of 1993-94 and alternative budget 1994-95 (Scenario IV) has been done.

Keywords: economic, policies, alternative, budget, scenario

Introduction

Attempt has been made not to draw a detailed picture of an alternate budget but to understand the macro outline of the budget based on alternative policies. With rising debt and interest burden there was a need for a change in fiscal policy change In the Indian economy. This paper shows the possibility of an alternative change to the IMF dictated budget adopted at that time. A comparison has been made between four scenarios. Scenario I has been drawn up to show the 1994-95 budget if the country would have been persisted with the observed trends of 80s. Scenario II are the projected estimates for 1994-95 if IMF dictated policies are followed. It is not the budget that Finance minister may present. In scenario IV, alternative budget proposal has been detailed out with a real fiscal correction. It has been assumed that the policies are in place for five years. The scenario III is the first year of transition.

Changes in taxation both direct and indirect has been done to raise revenue. Expenditures for various sectors has been estimated and the overall impact on the economy has been explained. A comparison between the revised estimates of 1993-94 and alternative budget 1994-95 (Scenario IV) has been done.

Finally, the critique has been given with the responses to the critique by Arun Kumar.

Theoretical Background

Financing of economic development through taxation-Kalecki Assumptions:

There are two classes in society: capitalists and workers
Workers do not save. Consumption is equal to their income.
Therefore total savings is equal to the saving out of the profit of the capitalists.

Economy is divided into two sectors: Department I, Investment goods and department II the consumption goods.

The value of production of each sector will be split between, consumption denoted by C1 or C2 and savings denoted by S1 or S2.

Value of production n department I= C1 + S1; Value of production n department I= C2 + S2

Since, workers consume all their incomes, the consumption demand in sector I will be met by sector II. Therefore, C1=S2.

Now suppose government taxes and invests. T1 and T2 are the taxes which go into giving salaries to workers by

government in the economy from department I and II respectively. T1' and T2' are additional taxes raised in two departments. Now T2 + T2' + S2 are the surplus of consumption goods. C1 + T are the total demand in the economy.

Therefore, C1 + T= T2 + T2' + S2 or C1 + T1 = T2' + S2

Adding T1' + S1 on both sides,

C1 + T1 + T1' + S1 = T2' + S2 + T1' + S1 I=T'+S

Investment is equal to total savings and total additional taxes. Therefore investment finances itself.

Results

Capitalists consumption will reduce by taxation of profits and hence will mitigate inflationary pressures. Secondly, it will also reduce demand for imported luxuries. Finally, financing of public investment by tax reduces creation of liquid assets. In presence of inadequate supply of consumption goods, inflationary spiral builds up and if liquid assets are present then speculative hoarding will be stimulated and thus aggravate inflation process.

Also there is no disincentive to invest on the part of capitalist ads only the profit created by public investment is taxed away.

$$I - T' = T' + S - T'$$

Ipr = S, where Ipr is private investment

Hence, when public investment is fully financed by tax, savings and profit generated are same as would be generated in absence of public investment.

Condition of the economy in Nep framework

- The rise in the fiscal, revenue and the budget deficits,
- The rise in the rate of inflation to double digit levels,
- Inability to proceed with the implementation of an exit policy and changes in labour legislation,
- Continuing stagnation in the industrial sector.
- Decline in agricultural production,
- Failure to attract adequate private investment in infrastructure industries and the worsening of bottlenecks in this sector by the end of the Eighth Plan.
- Inability of the government to proceed with the rapid privatization of the Public sector. Some steps have been taken in this direction but these are as yet halting,
- Subsidies on food and fertilizers have risen sharply,
- From available indicators, unemployment is on the rise,

- j. Foreign capital inflow has risen sharply but in the area of financial investments and not in industry. Intentions to invest have shown a sharp upswing but the actual flows are still small, and,
- k. The overall rate of growth of the economy has declined in 1993-94.

Inflation has come down from 16.5% in August, 1991 to 10% in 1993-94. Foreign exchange reserves have also arisen and foreign investments have gone up to about \$ 700 million. But most of these investments have occurred in financial activities rather than development. A bulk of these investments has been in low or intermediate technologies. Fiscal deficit has also come down from 8.5% of GDP in 1990-91 to 6% in 1993-94. Overall unemployment has risen, living conditions have deteriorated, de-industrialization, loss of food security, declining technological capability and decline of public sector has been the outcome of the present scenario.

Alternative Fiscal Policies for 1994-95

Direct Taxes

Top 5% in the urban sector and 1% of the rural sector have similar income and a bulk of it is black incomes. Therefore, these incomes need to be tabbed though direct taxes on gross profits and taxing the purchases out of black incomes i.e. luxury goods and real estates.

Low rates of Capital gains taxes encourage speculative activities. Therefore, there is a need to raise Capital gain taxes. The collection of wealth tax is at an average of Rs.20,000/- per head which is very low as Number and amount of wealth assessed has hardly changed in spite of a increase in the nominal incomes and growing disparities. Gift tax need to be strictly enforced, as it is exploited to save current taxes as well as estate duties by splitting up capital among family members. Estate duty needs to be restructured. Interest incomes should also be taxed so that black incomes could be captured. To avail the tax deductions rich split up their incomes among family members. To avoid it taxes should be levied on the family as a unit with allowances or dependents.

There is a need to simplify income taxation. All deductions related to savings except for PF need to be eliminated.

Indirect taxes

Indirect taxes raises costs as these are the taxes on the prime costs and result in inflation. Ultimate burden fall on the consumers. These are stagflationary.

Custom duties should be kept high for goods that's could be manufactured indigenously as it protects the domestic market especially small scale industries from unnecessary competition.

Excise duties should be lowered for basic and intermediate goods to make them cheaper. For luxury goods both these duties should be kept high to keep their consumption down in a poor country.

If excise duties on basic and intermediary goods are eliminated the tax structure would simplify and there will not be any need for MODVAT which includes a lot of paper work and complications. Also with a large number of small businesses operating in India it will take quite some time to completely move towards VAT.

Therefore there is a need to move towards higher direct taxes as their share in the total taxes is really low and it will be implemented only on the 5% of rich population in the country. Taxes should be simplified and their collection

computerized.

Permanent account numbers (PAN) should be allotted to all tax entities to make the whole process fair. The survey and Wealth tax departments need to be strengthened. Excise duty staff needs to be reduced.

Some rebate should also be given to regular tax payers. All salaried employees will get the benefit.

By raising direct tax collections borrowings should be reduced and as Fiscal Revenue and Budget deficits would be reduced.

Policies on expenditures and revenue

The three biggest expenditures – Interest payments, defence and subsidies cannot be curtailed in present circumstances. Interest payments are commitments from the pat. International threats do not allow any cut in defence expenditure and agricultural subsidies cut can be dangerous if monsoon fails. Cuts in Plan expenditures can raise social tensions. Therefore curtailment on revenue expenditures is going to be hard.

Under the alternative scenario Revenue would be raised from more direct taxes and custom duties. PSU disinvestment would be delayed tile they attain financial viability.

Exports of agricultural produce should not be accelerated otherwise inflation could rise. There is a need to check the flow of hot money from FIIs, NRIs and TNCs.

Comparison of the Estimated Budget For 1994-95 To The Alternative Budget

Projected estimates for the year 1994-95 have been derived from the revised estimates for 1993-94. On the other hand, the revised estimates for 1993-94 has been calculated on the basis of newspaper reports, RBI Bulletins information based on monthly/periodic reviews.

In the estimate budget 1994-95 the fiscal deficit will reduce from 6% of GDP in 1993- 94 to 5.5%. Tax collection will stagnate as direct taxes will not be raised but indirect taxes will be lowered substantially to liberalize imports.

Therefore, borrowings and public sector disinvestment will rise. Defence expenditure will rise and to reduce the fiscal deficit plan expenditures will be curtailed. Direct effect will fall on the social sectors. In such a scenario the economy will continue to stagnate. Industry will face inflow of goods from abroad, lower custom duties and lower demand due to lower purchasing power in the economy as a result of cut in plan expenditures. With higher incomes in hands of the rich speculative markets will grow. Rise in exports of essential items will yield the foreign exchange but at the expense of the poor who will have to bear the burden of high prices.

The alternative budget has been derived on the assumption that the alternative policies, as mentioned in the last section, have been in place for a period of five year. It has been assumed that it will take the economy 5 years to reach to the full alternative path from where it's today. The first year of transition has been taken the present year of budget 1994-95.

Revenue Side: For 1994-95, income tax collection will rise to 47,000 crores by bringing 40 million taxpayers under the tax bracket. Corporation, wealth and interest ax will fetch 18,000 crores, 78,00 crores and 1000 crores respectively. In total direct taxes will rise from Rs. 19700 crores to Rs. 75000 crores.

Indirect taxes on the other hand will fall. Custom duties will come down from Rs. 58000 crores to Rs. 46,300 crores

because of fall in prices of basic and intermediary goods. This will have positive effect of reduced prices in the economy. Also, profits of public sector enterprises will rise as they bear a large part of indirect tax burden. As a result the capital expenditure on PSUs by government will come down. Above all the non- tax revenue collection coming from PSUs will rise. As a result of all this, total revenue receipt will rise from Rs. 99,700 crores to Rs. 1, 46,000 crores.

Expenditure Side: On the expenditure side, non- plan expenditure is slated to decline from rs. 84, 175 crores to 83, 155 crores. All this will happen because of larger transfer of tax funds to the state. As a result the grants, loans and subsidies will be reduced.

Plan expenditure will go up as a part of contribution to central plan. It is also important to raise the central plan expenditure to meet the targets of the Eighth plan. Total Central plan outlay would rise to Rs. 78000 crores in Alternative budget estimates, 1994-95 to 53, 00 crores in 1993-94 (revised estimates).

The increase in Plan investments will not lead to inflation as these investment is based on taxation as I have discussed in the theory above. As a whole, States and Uts will gain Rs. 10,000 crores and this amount will hopefully be spent on social developments in the country.

Biggest change is seen in revenue account, where the deficit of Rs. 25, 285 crores in 1993-94 (RE) will become a surplus of rs. 3, 182 crores in 1994-95 (AE). This would then be available for capital account. Fiscal deficit is expected to be around 45 of the GDP.

By taking into account, increased expenditures on social sectors, rural infrastructure, construction activities, small scale sector, improved purchasing power of the poor, the principle goal of the alternative budget of full employment is expected to be achieved.

The direct tax levied on rich households is not a strategy against them as the amount of tax is only Rs. 37,000 per capita and with increase in rate of economic growth, their incomes will raise at least by Rs. 67,000 crores.

Tax on gross profits will cut down on corporate sector wastes.

For PSUs loss of profits through corruption will be checked. Non payments of dues and delays in budgetary allocations will be checked.

Agriculture sector would be benefitted through better infrastructure and lower costs of input as a result of policies such as reduction in indirect taxes on basic goods and higher plan allocation in rural sectors. As a result income generation will take place in the rural areas and gradually when people are able to pay for services and inputs themselves, subsidies can be withdrawn.

Speculative activities will be reduced in the real estate will lead to availability of houses to the poor segments of the population, criminalization in the society will decline. Reduction in wastes by top 3% of population will release vast resources for the rest. Reduction in inflation and greater employment generation will increase real incomes and people will have greater access to better living conditions.

Critique

Oomen is a member of PCAEP has critiqued the Alternative budget.

1. Oomen suggested that there were many things that could be presented in greater detail and from a different

perspective than in the union budget.

2. He also pointed out the need for educating the people and stimulating constructive thinking.
3. "Oomen makes a plea for changing the budgetary categories plan/non plan or for adoption of zero based budgeting." [1]
4. He also suggests that the philosophy of the alternative policies and the broad objectives of the AB should have been pointed out.
5. Oomen states that "stabilization is an IMF concept with considerable theory and operational meaning attached to it"

Reply to critique

Arun Kumar who was also a member of PCAEP, has responded to this critique.

He agreed with Oomen that there were many things could have been given in even greater detail but neither time nor our resources permitted an even more elaborate document. It was after all an attempt to brief out only the macroeconomic policies which has been mentioned in the Report.

For the second point, "It is noted in the AB that our exercise is a beginning and only one possible attempt and that it may be the basis of other efforts... PCAEP has believed that alternatives can only be discussed in a macro framework since there is a need to present a consistent set of policies which do not contradict each other as happens so often when policies are conceived of in isolation. Such a framework is provided by the union budget or the Plan" [2]

Thirdly, budgetary categories cannot be changed as these are the categories used in Union Budget as well and for the comparison it is important to maintain same base.

The philosophy and the objective has been pointed out in the document.

He points out that the term stabilization has been used in Polak's model and therefore it is not IMF's term and it can be used by others

Some critiques has also argued that the Alternate Budget has fallen into a number game and government can use it to divert attention from such critiques. "As already argued, there are no correct numbers and attacks will come with or without numbers. In fact, charges will stick more if a consistent set of numbers are not given. Critics of NEP will have to live with being attacked by the proponents of NEP. After all, we also challenge their contentions. This is part of any debate and we should be concerned with the substance of what we say." [3]

Conclusion

The scenario I presented in the document clearly showed emergence of deepening crises if the economy continues with the 1980s policy framework. There was definitely a need for the change in the policies. Opposing the NEW ECONOMIC POLICY adopted by the government, PCAEP shows that there is a possibility for an alternate Budget. With the estimated figures proposed for scenarios II, III and IV we saw how fiscal deficit could be reduced and plan expenditures raised by comparing figures for revised estimated for 1993-94 and the alternative estimates of scenario IV.

"Critiques of NEP (and now the new G ATT), have been often dismissed as woolly headed and contradictory since they do not show how they are consistent with the Country's resources base. For instance, it is often suggested that resources do not exist to create full employment or that

public sector has to be sacrificed so as to release resources for the creation of rural infrastructure, etc. Only in a macro setting can it be shown that all these things are simultaneously feasible in a reasonable time frame with the alternative policies contained in AB.”^[4]

Hence AB is a technical document showing the anti-people character of the new economic policies and it shows how through using countries own endogenous resources by changes in fiscal policy regime India could achieve growth targets. It was basically an alternative to the IMF- dictated budget which could represent the view of all those opposed to NEP not simply through arguments but with numbers.

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