# A Recipe for Continuing Stagflation

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This was never going to be an easy budget to present. Finance Minister P. Chidambaram had to juggle many different considerations, but three must have dominated. First, the need to bring the economy out of its current spiral of stagflation, with investment and economic activity both decelerating even as inflation continues to rule very high. Second, the need to impress the global "epistemic community" — consisting of rating agencies, representatives of international capital and domestic big business generally as well as other mainstream figures — all of whom share the view that fiscal rectitude is always desirable and the only deficits that can be tolerated are privately generated ones. Third, the need to placate his own party and others in the Indian political establishment who are concerned at how the announcements he makes in this budget speech and related economic policies will affect the common people of the country. The last consideration is important because this is the last full budget before the next general election, which is due in a little over a year.

Those analysts who have gathered some idea about Mr. Chidambaram's own predilections will have known what to expect. The Finance Minister is a fiscal hawk who is much more likely to prefer fiscal contraction in most circumstances, even when economic growth is on a downward trend. He is also a champion of the interests of large private capital. While he is no doubt currently constrained by the political compulsions of a government soon to face elections, he has clearly sought to achieve the second objective, even if at the cost of generating more stagflation and making material conditions harder for much of the population.

Not surprisingly, his speech had to obfuscate this unfortunate reality. In what will probably go down as one of the most boring, repetitive and scattered budget presentations in recent memory, Mr. Chidambaram did not work with smoke and mirrors so much as rely on the deadening effect of providing detailed minutiae of particular programmes and making various vague claims and proposals, often even without providing the fiscal content of such plans.

## Macroeconomic Implications

In the event, his silences were actually the more important part of his speech. For what the Finance Minister did not actually outline were the macroeconomic implications of his chosen strategy of fiscal consolidation at all costs. The approach seems to be that showing some amount of fiscal consolidation is essential, that this can only be achieved through cutbacks in spending (regardless of how this translates into supply shortages or higher inflation in future) and that growth will miraculously return once private investors (both domestic and foreign) are persuaded that fiscal deficits will be kept in check. The positive role that public spending plays — in providing essential infrastructure that is the basis for future growth, in improving the conditions of life and productivity of the people as a whole, in generating internal demand at a time when external demand is problematic, and in ensuring some stability in the prices of essential items of mass consumption — all these have simply been ignored.

Consider what has been achieved in the current fiscal year: containment of the fiscal deficit to an "acceptable" level of 5.2 per cent of GDP, essentially by sharp reductions in much-needed Plan spending. The revised estimates for the current fiscal year show that Plan spending was nearly 20 per cent below the budget estimates for 2012-13. This was effected by across the board cuts in all the major sectors, including those that directly affect the livelihood and well-being of the people. Some sectors suffered severe cuts, with unintended consequences that we may have yet to experience — for example, actual plan spending on irrigation and flood control is estimated to be only one-third of the budget amount, while important sectors like industry and minerals, science and technology and communications also suffered deep cuts. Even agriculture, rural development and social services (health and education) experienced sharp cuts in actual expenditure in comparison to the allocations made in the budget last year.

But the proposed budget is slightly more cynical in its approach to fiscal consolidation. To begin with, there are fairly extravagant claims about future tax collections on the basis of very minor increases in some taxes (with even the most optimistic self-assessment suggesting additional resource mobilisation of only Rs.18,000 crore in total). Despite this, the FM has budgeted for a significant increase in tax collection of 19 per cent, even though nominal GDP is projected to increase by only 12.9 per cent. It is hard to understand such a buoyant prediction, especially when the current year already shows a significant shortfall of more than five per cent of actual tax collections over the budgeted amount.

Meanwhile, while Plan outlays have been increased slightly over the low revised estimates of the current year, they show hardly any increase when compared to the budget estimates for the current year. And the worst sting in the tail is the proposed reduction/elimination of fuel subsidies: the total subsidy bill is to be brought down by more than Rs.26,000 crore — almost entirely on account of reduced outlays on fuel subsidies. With global energy prices still ruling very high, this can only mean that the Central government is preparing to force Indian consumers to pay global prices for fuel, even though per capita incomes are only a small fraction of the global average.

Since fuel is a universal intermediate, this is bound to affect all other prices, including those of essential goods and services like food, transport and so on. And so this is an aggressively inflationary move, which is more than surprising if the government is truly concerned about containing inflation and particularly food prices.

As a result, Budget 2013-14 will deliver neither higher growth nor improved conditions of life — instead it is likely to worsen the stagflationary tendencies in the economy. Given that poor employment conditions and food insecurity are rapidly emerging as the most significant political issues, this seems like political hara-kiri. Once this reality sinks in, it is likely that even people in Mr. Chidambaram's own party are likely to become more restive about this strategy.

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