The Modi Government's Economic Strategy*

C.P. Chandrasekhar

It will soon be a year since the NDA government under Prime Minister Modi took office. It has taken as much time to identify the contours of the economic strategy that this version of the NDA would adopt. When the government took office, within the Sangh Parivar, positions varied from Modi's obvious fancy for and desire to "attract" big domestic and foreign capital to the professed economic nationalism of the RSS and the Swadeshi Jagran Manch. With an absolute majority for the BJP, won under Modi's leadership with RSS support, the mix of policies that would find favour and the manner in which they would be implemented was unclear. The campaign's emphasis on 'governance' and 'development' did not matter much.

But with the government's ordinance-based economic policy push, the details of the first full-year budget of the NDA, and the refurbished, two-volume version of the Economic Survey now before us, it seems possible to piece together a picture of the NDA's economic strategy. Over the medium term, at the centre of that strategy is the objective of making India the fastest growing emerging market with an enhanced role for manufacturing, captured by the "Make in India" pitch. But that would take time. Productive foreign capital has to be wooed, old capacities need to be re-engineered, new capacities must be put in place and goodwill has to be won in international markets. Hence, the immediate objective seems to be to create the conditions necessary for realising that ambition and doing it in a way that ensures that growth is raised and sustained.

The Survey and the railway and general budgets seem clear on how this is to be done: increase public investment in infrastructure (power, roads railways and ports) and clear the obstacles that stall the progress of infrastructure projects. The land acquisition bill in its revised and predatory form is clearly seen as crucial for the latter. And, the budget has gone some way in implementing the former element of the economic agenda. The allocation for road transport and highways, which was Rs. 25,477 crore in 2013-14 and an estimated Rs. 30,669 crore in 2014-15 is to be hiked by 40 per cent to Rs. 42,842 crore in 2015-16. The railway budget for 2015-16 provides for a Rs. 1 lakh crore annual investment plan, which amounts to a large 50 per cent increase compared with the previous year. Of this amount, Rs. 40,000 crore has been provided by the general budget. As a result, roads and the railways alone are to get an additional Rs. 50,000 crore of budgetary support. But that is as far as the government can go. Power, which saw allocations rise from Rs. 4,927 crore to Rs. 1,544 crore between 2013-14 and 2014-15, has been provided a lower Rs. 6,726 crore for 2015-16.

Thus, while the attempt at a public investment-led infrastructural push is visible, it is restricted to and focused on a few sectors. However, given the overall thrust of the neoliberal agenda, especially its focus on fiscal consolidation, the emphasis on public investment is surprising. The Survey explains why this is needed. It sees private investment as being constrained, at least in the "short to medium term", because of a huge debt build up that has resulted in "weak corporate balance sheets" and "an impaired banking system". Till such time that the private sector is ready to play its role, the Survey argues, "public investment, especially by the Railways, will have to play a catalytic role." (The emphasis on the railways seems to be aimed at giving this plank of the NDA agenda a distinctive flavour, since the effort to strengthen the road infrastructure began well before this government.) Stated otherwise, after twenty-five years of pursuit of neoliberal reform that privileges the private sector, that sector is not up to the task of driving growth. Hence the public sector must come in.

But pursuing a public investment-led strategy while sticking to fiscal consolidation is problematic. Yet the government seems committed to that goal. Finance Minister Arun Jaitely claims that he has met his fiscal deficit target of 4.1 per cent of GDP (set in the July 2014 budget). We have to wait for the final numbers to check the veracity of that claim. But the intent is clear. And he plans to stick with it. The fiscal deficit is slated to come down to 3.9 per cent in 2015-16 and gradually to 3 per cent in three years time. If capital expenditure must rise, but the deficit must come down, then either revenues and capital receipts that do not enter the deficit calculation (such as those from disinvestment) must be increased or expenditure in areas other than infrastructure must be curtailed to garner the necessary resources.

The alternatives too are limited. The commitment to neoliberal reform limits the willingness of government to obtain resources by taxing surplus incomes adequately. Rather it wants to provide tax concessions to the private sector. It has promised a reduction in the corporate tax rate from 30 to 25 per cent in stages, though it has postponed the start of implementation to next year. It has imposed a 2 per cent surcharge on the “super-rich”, or those with taxable incomes of over Rs. 1 crore. But to soften that minor blow, it has abolished the wealth tax, which though hitherto unsuccessful in raising much by way of resources, had the potential to help identify assets disproportionate to stated incomes pointing to tax evasion. In the event, direct taxes are not of much help.

As a result the government has been forced to rely on indirect taxation and expenditure reduction. In a cynical move, the government, which has deregulated petrol and diesel prices so that consumers bear the burden of or benefit from fluctuations in international prices, has sought to “steal” a significant part of the benefit of the fall in international prices from the consumer, through increasing excise duties. It has hiked excise duties on petroleum products repeatedly as prices fell, and expects to garner around Rs. 58,000 crore in revenues over the full year 2015-16 from additional and special excise levies on motor spirit and diesel oil. This gain is in addition to the fall in petroleum subsidy because of the decline in oil prices and the change in pricing regime. The petroleum subsidy which fell from Rs. 85,378 crore in 2013-14 to Rs. 60,270 crore in 2014-15 is expected to go down further to Rs. 30,000 crore. That is a Rs. 30,000 reduction in expenditure under just one head.

In fact Budget 2015-16 makes clear the intention of the excise duty hikes on petroleum products. It has converted an amount equal to Rs. 4 per litre of the existing excise duty on petrol and diesel into a road cess, to finance part of the infrastructure push. That alone is expected to deliver Rs. 40,000 crore for the purpose. Combined with the decline in petroleum subsidy and the balance remaining from excise levies on oil, the infrastructure plan is fully funded. In practice, of course, a part of this regressive levy has been handed over as concessions to the private sector. As a result the budget claims that the indirect tax revenue gained out of its proposals is only Rs. 23,833 crore in a full year, out of which it has handed out direct tax concessions to the tune of Rs. 8,315 crore, leaving a balance of Rs. 15,518 crore. Not surprisingly, overall, India’s already low gross tax revenue to GDP ratio, which had fallen from

10.4 per cent in 2012-13 to 10 and 9.9 per cent respectively in 2013-14 and 2014-15, is slated to rise to just 10.3 per cent in 2015-16.

So while the infrastructure push is partly financed, the problem of reducing the fiscal deficit remains. The result has been a drastic cut in expenditures. The ratio of total central expenditure to GDP has fallen from 14.1 per cent in 2012-13 to 13.8 per cent in 2013-14, 13.3 per cent in 2014-15 and is budgeted at just 12.6 per cent in 2015-16. Cuts in specific welfare expenditures have been quite sharp. Expenditure on public health is budgeted to fall from Rs. 1,963 crore to Rs.1,767 crore. The allocation for the Integrated Child Development Services programme is to be reduced from Rs. 16,590 crore to Rs. 8,677 crore. The food subsidy has been kept almost unchanged in nominal terms: Rs. 122,676 crore in 2014-15 and Rs.124,419 crore in 2015-16. That implies a real (inflation adjusted) reduction in a period when food security is to be enhanced. Finally the allocation for the Rural Employment Guarantee Scheme has been kept at a grossly inadequate Rs. 34,699 crore. The spending in 2014-15 was Rs. 33,000 crore. But that does not include the Rs.6,000 crore due to states as arrears against wage payments already made in the course of last year. So actual expenditure was at least Rs. 39,000 crore, excluding wage arrears due and still unpaid by the states. So the minimum allocation should have been Rs.45,000 crore for 2015-16, to cover the arrears and the Rs. 39,000 crore actually spent.

These cuts were planned. While accepting that combining fiscal consolidation with a public investment push requires raising the tax-to-GDP ratio (which has not been ensured), the Survey recommended that “expenditure control should be consolidated while ensuring that there is switching from public consumption to public investment, with a focus on eliminating leakages and improving targeting in the provision of subsidies” (emphasis added). This means pruning expenditures on areas that contribute to welfare, to provide resources that (combined with “non-debt capital receipts” from privatisation of public assets) can help finance the government’s limited contribution to an infrastructure push, without deviating from its commitment to reducing the fiscal deficit. Crucial to this strategy is the move to curb the outlay on subsidies that benefit the poor by shifting from actual public provision of pre-specified quantities at pre-specified prices to direct benefit transfers (or cash transfers), in areas stretching from food to kerosene, rail transportation, electricity and water. This is what the use of the (awfully named) JAM Number Trinity (Jan Dhan Yojana, Aadhaar and Mobile numbers) is expected to achieve.

Despite all this, Budget 2015-16 not only involves expenditure contraction when measured relative to GDP, but does not provide anywhere as much as needed to create the infrastructure to support its “Make in India” thrust. In the case of the railways for example, the budget provides just Rs. 40,000 crore out of the Rs. 1,00,000 crore investment planned. Where is the remaining Rs. 60,000 crore to come from? Besides the surpluses of the railways itself that are expected to come partly from new freight increases, the Railway Minister is expecting to resort to market borrowing to the tune of Rs.17,655 crore through the Indian Railway Finance Corporation (IRFC) and Rail Vikas Nigam. This compares with the Rs. 12,045 crore raised in 2014-15. Additionally, the Railways expects to raise institutional finance to the tune of another Rs. 17,000-odd crore by creating new financing vehicles. According to the Railway Minister: "These may include setting up an infrastructure fund, a holding company and a JV with an existing NBFC or a PSU with IRFC, for raising long-term debt from domestic as well as overseas sources, including multilateral and bilateral financial institutions that have expressed keen interest in working closely with Railways in this endeavour." Plainly put, the contribution from the budget is going to be supplemented with resources that are one-and-a-half times as much, most of which is to come from borrowing.

In sum, since budgetary resources are inadequate to finance the infrastructure push in full, the government plans to resort to borrowing from the open market or through specially created vehicles. Since that borrowing effort, if successful, would show up in the books of the vehicle or project concerned, and not on the government's budget, this would not violate the requirements set by the plan for fiscal deficit reduction. In keeping with this strategy, Budget 2015-16 promises to set up a national infrastructure investment fund that will raise resources through borrowing. Such promises have been made by governments in the past as well, with little success.

Clearly, if mobilised, these resources would be provided to projects in the PPP mode as part of a conscious strategy. The government's problem is that thus far the experience with PPPs has not been encouraging, leading the Survey to the conclusion that "the PPP model at least in infrastructure will need to be refashioned." According to the Survey, "India's recent PPP experience has demonstrated that given weak institutions, the private sector taking on project implementation risks involves costs (delays in land acquisition, environmental clearances, and variability of input supplies, etc.). In some sectors, the public sector may be better placed to absorb some of these risks." Hence, the public sector should take on more of the risk. The Budget speech made this clear when it said: "The PPP mode of infrastructure development has to be revisited, and revitalised. The major issue involved is rebalancing of risk. In infrastructure projects, the sovereign will have to bear a major part of the risk without, of course, absorbing it entirely." That is surprising since even now the main criticism with regard to PPP projects is that the public sector takes on much of the risk, while the private sector gets much of the profit. Since it is clear that the infrastructure push would be largely financed with debt, under the new risk-sharing mechanism the government could well end up guaranteeing the debt. Besides expenditure reduction and off-budget borrowing, the other source of infrastructure finance is receipts from privatisation and disinvestment. However, the government thus far has not been successful in realising its disinvestment targets. Against a target of Rs. 63,425 crore from disinvestment receipts in 2014-15, it has managed to raise only Rs. 31,250 crore. It has been more successful with the ongoing sale of spectrum. But that is an option that is lost once the sale has occurred, and cannot be exploited every year. So the government has budgeted for receipts under the disinvestment head of Rs. 69,500 crore during 2015-16. It remains to be seen whether this time around it would be successful. If not, the problem of financing the infrastructure push while meeting the fiscal deficit target would only intensify.

To sum up, while the Modi government thinks it has a growth strategy, and is willing to slash expenditures that benefit the poor and middle classes to pursue that strategy, it remains unable to mobilise the resources to implement its agenda. But in its desperation to push ahead it is willing to borrow indiscriminately to support the private sector, as well to adopt measures such as the land acquisition bill that justify displacement and the destruction of livelihoods in the name of development. Finally, it is willing to offer foreign investors a host of concessions in the hope of attracting them into sectors they are not keen to invest in. All evidence suggests that this would fail as a strategy, though its costs would be paid by the citizenry – unless political opposition puts a halt to this futile effort.

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