

# Reconciling the Irreconcilable

*The finance ministry and Planning Commission going head to head in a battle over the integrity of Fiscal Responsibility Budget Management targets will inevitably result in a “lose-lose” outcome. Why do the finance minister and deputy chairman of the Planning Commission not consider the possibility of another “golden rule” for guaranteeing public fiscal rectitude that would achieve both their aims?*

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Recent discord between the finance minister (FM) and the deputy chairman of the Planning Commission (DC) – on loosening by two years the rigour of deficit reduction targets required by FRBM – appears uncharacteristic and perhaps unnecessary. In not agreeing to DC’s suggestion for relaxing Fiscal Responsibility Budget Management (FRBM) mandated targets, the FM – supported by RBI – is defending the hard-won patina of fiscal credibility (after too long a period of fiscal profligacy) by making a modest start toward achieving that goal. In trying to meet the UPA’s commitments for priority social spending and perhaps to lock in a growth rate of at least 8 per cent for another year or two (although, as Ila Patnaik points out, without any accountability requirements attached), the DC wants to loosen FRBM targets. This tendency seems to be in keeping with the argument he made a year ago about sequestering approximately US\$ 5 billion of reserves for infrastructure spending – a proposal that met equal resistance from the FM and RBI and was eventually dropped.

The unfortunate reality is that the FM and DC are both trying to achieve laudable goals. But resolving the conflict between them by one or the other “losing the argument” may create unacceptable risks for India. And it would certainly send the wrong signals to the outside world whoever won. It would be no bad thing for India and Indians to regard an 8 per cent growth rate as “normal” and accept anything less as equivalent to a recession. That is what Singapore did between 1970 and 2000 when growth of less than 5 per cent was viewed by its government and population as an economic crisis. But it is equally important for India to reduce its gross consolidated fiscal deficit (including quasi-fiscal

accounts) from the current level of 11 per cent of GDP to achieve greater fiscal discipline and eventually create more headroom for manoeuvre in enabling priority public spending. Both objectives need to be achieved. Is the current conflict over relaxing FRBM targets obscuring other (and better) alternatives to squaring that circle?

Going head-to-head in a battle over the integrity of FRBM targets will inevitably result in a “lose-lose” outcome for the combatants, and for India, regardless of whom “wins” the argument temporarily. So, why don’t the FM and DC consider the possibility of another “golden rule” for guaranteeing public fiscal rectitude that would achieve both their aims through more imaginative out-of-the-box thinking? Simply put, why not stick to the FRBM deficit reduction targets, but consider an additional rule that would require the central government to sell public assets (vizits shareholdings in PSUs) automatically, without further parliamentary argument or approval after core legislation is passed, whenever the public debt-to-GDP ratio exceeded a prudent level, of say 60 per cent (this is an arbitrary figure borrowed from EU rules).

Instead of compromising on deficit reduction targets in a way that threatens the framework of discipline that has been built up so painstakingly in getting FRBM passed – and, given the political dynamics of India, who is to say that two years might not become 20 years – such a fiscal rule (which is a “stock” rule that augments the “flow” rule of mandated deficit reduction targets) would require the government (mandatorily) to reduce its stock of public debt (and therefore annual debt service obligations) in order to fund any new social or infrastructure spending. It could be constitutionally embedded through legislation similar to FRBM. It is a rule that would protect rectitude on the balance sheet side of the fiscal equation in the same way that FRBM does

on the income statement side. Such a rule would command majority support in Parliament if the Congress Party and the BJP put aside, just for once, their differences and came together opportunistically to legitimise something that would safeguard India’s economic future – a point we shall return to contemplate in more depth later. That rule is in line with the stated policies of both these parties that favour continued economic reform.

Such a debt-GDP ceiling rule has many other advantages that are too obvious to require much elaboration. It would restore the stalled momentum of divestment that is now hurting the fisc and the Indian capital market. It might get the Indian public and polity to legitimise the notion of privatisation on a scale that many “reformer-stalwarts” in both the Congress Party and BJP dream about but dare not go public with. It would give a massive boost to Indian capital markets and to the badly needed process of financial system reform for the next three to five years. It would create more headroom for significantly expanded social and infrastructure spending if the government went beyond the mandated 60 per cent debt ceiling limit and reduced debt even further. In these contexts, the potential which such a rule would create for accelerated reform (and for meeting the objectives of both the FM and DC) as seen through illustrative figures is simply staggering.

With total consolidated debt now standing at about 83 per cent of GDP such a rule would require the government to divest immediately about 23 per cent of GDP in public assets and thereafter would require the government to keep selling state assets to fund new spending programmes. In a US\$ 700 billion or INR 33 trillion economy (nominal), the initial debt reduction mandate would translate into sales of over US\$ 160 billion (i.e., INR 7.6 trillion or Rs 76 lakh crore in the vernacular) in state-owned assets. Clearly this amount of divestment could not be undertaken in a year or two. It would be beyond the digestive capacity of the domestic capital market to absorb incrementally much more than half that amount even over a longer period. But there is more than enough demand in global capital markets – on the part of both portfolio and direct investors to absorb the remainder without hiccups and without endangering India’s sovereignty in any way.

Such a quantum of divestiture might easily be achieved in a four to five-year time frame. That volume of public asset sales would probably attract an incremental \$ 30-50 billion of portfolio capital flows

into India (over and above those that might normally be expected to occur) over the next four to five years, not to mention another \$ 20-40 billion by way of associated foreign direct investment that went into both purchasing such assets as well as expanding them. The simple process of divestiture from the public to the private sector (especially if it resulted in the government reducing its stake in PSU banks, oil companies and heavy goods industries sooner than presently envisaged) would raise both the efficiency and productivity of overall resource use (as has been unarguably witnessed with divestitures since 1992) as well as the efficiency and effectiveness of financial resource allocation. That would probably lock in a growth rate of 10-11 per cent rather than the 8 per cent we have come to know and love, over those four to five years. It would probably result in increasing India's reserves to the \$250-300 billion level in a relatively short span of time; creating a much larger and more comfortable cushion for risking full capital account convertibility sooner rather than later (certainly no later than 2010).

If such a large amount of unarguable "public good" can be expected to emanate from the application of this relatively simple new golden fiscal rule, what is the problem with going ahead and legislating for it? Simply put, the problem is politics; especially the politics of an untenable lack of cohesion and consistency of purpose and view, within an unwieldy and increasingly fractious UPA coalition. Its minority left wing constituents are bent on holding India to ransom by blocking every essential reform measure and putting the prospect of PSU divestiture and financial system reform (through exit from state-owned banks) in cold storage indefinitely.

In India's political climate bitter (often infantile) opposition is practised simply for the sake of opposition and no other purpose. This is an unfortunately counter-productive tendency – especially in developing countries that need to deliver development rapidly – that Westminster-style parliamentary democracy practised by novices does little to discourage. In such a political system, with the UPA and NDA opposing one another almost mindlessly like automations rather than thinking people, the passage of a "debt ceiling" fiscal rule may seem an implausibly idealistic outcome to hope for. It would not be so implausible if the Congress Party and BJP jointly voted it through. After all such a rule accords with their views on the urgency of continuing with reforms that

were started and continued by governments led by both parties. But, in the present scenario, the official opposition appears to have no credible agenda or leadership of its own – other than entering into senseless, inane controversies with the UPA about singing patriotic songs, and catching illusory moles. With these diversions pre-occupying them, why should the BJP join hands with Congress in passing such a fiscal rule when that might increase the chances of the Congress or UPA winning the next general election?

There is no easy answer to that question except perhaps to suggest another utopian ideal that, in the mind of most Indians, seems beyond contemplation; i e, in the next general election the Congress and BJP might consider joining hands in a grand coalition to ensure that India's progress towards becoming a developed nation is not senselessly hindered by the more absurd exigencies of coalition politics in both coalitions. That would neatly sidestep the Congress Party's performance and delivery

being handicapped by its dubious "allies" in the criminal middle, and on the more honest, idealistic but totally impractical left.

By the same token it would extricate the BJP from relying on its even more dubious, communal, criminal and divisive "allies" on the extreme right. These alliances, on both sides of the aisle, are diminishing the stature and credibility of the core national parties around which these alliances have been formed. The expediency of coalitions is resulting in lunatics on both the extreme fringes of left and right being catapulted into positions of undeserved prominence and leverage where they can inflict real damage to the country. These misguided non-entities would be marginalised by a grand coalition as would the possibility of any Third Front emerging from a miscellaneous ragtag of small insignificant fractional parties driven by: incompetent individuals, the expediency of regional/local politics, and no sensible or credible common agenda. **FWW**

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