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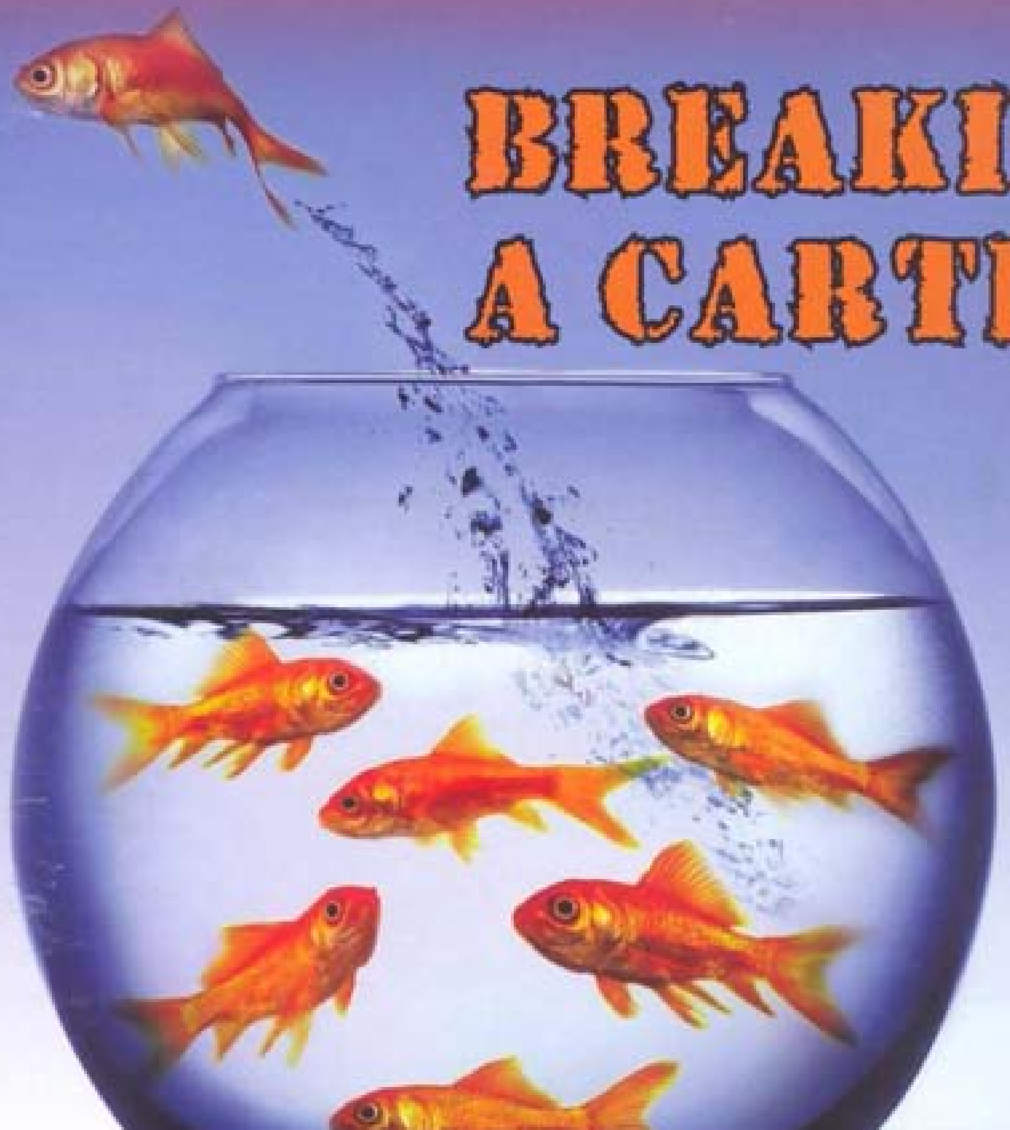

Budget 2011 growth target needs inclusive governance with reforms

R P Gupta

The 9 percent growth target finalised in the recent budget 2011 truly needs to be appreciated, since it reflects the government's desire for growth despite all odds. We should not forget that the pre-crisis growth was due to better environment prevailing in the country and favourable global scenario. On the other hand, the post crisis growth was driven by higher government spending. Today, the country is facing high inflation, current account imbalance and relatively higher fiscal deficit. Rising crude price tends to be the biggest source of concern at the moment. The manufacturing share in the GDP is 16 percent which is at an all-time low. Business confidence is also reported to be lower. The investment climate is not so favourable than what it used to be at the beginning of the decade. Public mood has become relatively hostile towards big ticket investments. No significant investment has come up in agriculture in the last decade and hence, we are still dependent on the rain Gods, using conventional technology which results in low productivity. Infrastructure spending is much below the target of the Planning Commission and hence, we are increasingly finding it difficult to cope up with the economy growth.

But, at the same time, 9 to 10 percent growth rate is sort of a compulsion for the country, after looking into the aspirations of the public for better income and better living standards. Even the aspiration of rural population has gone up in recent times due to better exposure and connectivity through electronic media and mobile telephony. Under the circumstances, if we want to achieve 9 percent growth target, the government has to initiate a series of structural reforms in a bold manner, as was done in the early nineties. The on going reforms seem to be half-hearted in nature. License and control era is re-entering the economy in disguise through multiple regulations on the productive sector. However, now the country cannot afford to reverse the growth cycle in order to fulfill the aspiration of young population. Hence, the only option is to initiate bold reforms even after the budget.

Inclusive governance is key reform

The responsibility of growth target may not be limited to the economic wing, but all wings of the government have to participate. Non economic wings may be also made growth centric. Even the regulators have to be growth conscious. Awareness for growth needs to be created even at the lowest level of government upto district and gram panchayat level authorities, including public representatives. Everybody has to contribute, facilitate and participate in the growth process. In other words, the governance has to be inclusive from top to bottom in all layers and covering all wings.

The purpose of GDP growth is not limited to increase government revenue alone, but to mobilise higher public income and higher savings. It will provide higher monetary resources for infrastructure or development-related spending. But unfortunately, most of the departments in the non economic wing of the government are at present engaged in enforcing tougher regulations and norms on the productive sector on the plea of public interest. This creates hurdle to growth and ultimately hampers public interest only. We should take a lesson from past history of country from 1950-1990 during the control regime. Hence, inclusive governance is essentially required with team spirit.

The GDP target may be fixed state-wise and district-wise. Accountability may be fixed for non achievement of target. Central government allocations may be linked to performance of the state and district. Any regulation which is hindering growth may be amended in the fastest possible manner. Activism may take a backseat for at least five years. Long term benefits of growth are to be communicated at all levels. This strategy of inclusion alone can facilitate to achieve targeted growth.

Fiscal reforms essential for investor confidence

In the Budget 2011, the government has done a commendable job to reduce fiscal deficit from 5.5 percent in 2010 to 4.6 percent in 2011. Off budget subsidies have been also included in the budget for greater transparency. This has been targeted despite no major hike in tax rates. State governments may also work with similar spirit in the larger interest of the nation. However, the spirit is to be extended in the subsequent budgets more vigorously to achieve surplus budget instead of deficit budget in the coming years.

Higher tax rates beyond reasonable limit always leads to non compliance and fall in revenue target, as past experience has revealed. Hence, non tax revenue is to be enhanced through innovative methods for the coming four to five years, till deficit is eliminated in total. Interest and debt repayment is ₹3.69 tn (2.68+1.01) for the year 2011-12. This will eat away sizeable portion equivalent to 46.7 percent of the revenue receipts (₹7.90 tn). Hence, interest rate needs to be reduced by at least 250 basis points through innovative methods. High cost debt is to be replaced with low cost.

Tax payers' money is to be spent judiciously and carefully in the larger interest of the nation, instead of adopting short term populist measures. Expenditure reforms should take priority. Out of the total budget expenditure of ₹12.58 tn, the capital expenditure is hardly ₹1.50 tn and balance is revenue expenditure. The ratio of revenue/capital expenditure is to be tilted in favour of capital expenditure to create long term assets for future income and at the same time, reduce the inflation. As per the Twelfth Plan, India needs to spend US$200 Bn (₹9 tn) every year on infrastructure. Obviously, budgetary resources cannot meet beyond 25 percent of the requirement and balance has to come from private resources. Hence, government funds may be leveraged like promoter's equity in the private sector project. In other words, government should provide seed capital instead of 100 percent funding of any infrastructure project. Similar concept of leveraging may be extended in social sector revenue spending through innovative methods. This will help enhance government spending power in the targeted schemes and will also help to achieve 9 percent growth rate on consistent basis.

Tax reforms will fuel growth and revenue

GST is in the right direction of taxation reforms. It may be implemented at the earliest. However, in the proposed scheme of GST, consuming states are benefitted more in comparison to producing states. As much as 50 percent of IGST may be shared by producing states so that the states take interest in promoting the productive sector. DTC is a half-hearted reform. It requires further review before implementation. If maximum tax rates are further reduced to 20 percent level, there will be a big boost to the economy. Compliance shall improve and the ultimate tax collection in absolute terms shall improve.

Our government may try the innovative method of converting personal income tax to expenditure tax and to merge with GST. In this way, rich people will spend more and be compelled to pay more tax. This innovative method will give a big boost to tax compliance and lead to higher savings without affecting government revenue. Interest rate will come down and our dependency on foreign funds will reduce. This higher saving may then be utilised for country's growth. Generation of black money shall also reduce. Preventive steps are always better in comparison to subsequent regulations. Let us be trend setters.

Besides tax rates, it is more important to have simpler laws with friendly environment. DTC is still based on the concept of mistrust, which is no good. History speaks that, frequent coercive actions do not contribute additional revenue, but promote corruption only. Such bold reforms will give a strong message to foreign investors and also create a situation where monetary resource shall never be a constraint for the country's growth.

Legal and labour reforms are long overdue

Our country needs a big dose of legal reforms. Several hundred acts are applicable on the productive sector. As such, compliance becomes too difficult. This creates hurdles in growth and results in corruption. If laws and regulations are simplified, majority of corruption will be automatically over. It will also attract foreign capital which we need urgently to meet the growth target, particularly for infrastructure spending.

Present labour laws reduce the labour demand and hence, are not employment friendly. Moreover, the labour laws are mostly applicable to the organised sector which comprises of only 5 percent of the country's total labour workforce. Hence, it is better to bring the major reforms here so that demand from organised sector increases. As it is, there is shortage of skilled manpower as on date. Hence, it is the right time to undertake labour reforms. It will improve productivity and create more employment to facilitate growth.

Land reforms essential for equitable growth

It is interesting to note that states like Orissa, Jharkhand, Chhattisgarh and others in the north east, which are otherwise rich in minerals and forest resources, are relatively under developed. Gross injustice is being done to these states and the average per capita income of these states is low. The existing land policy is much too restrictive to allow use of forest area or tribal land for large industrial and infrastructure projects. As a result of which, such large projects are shifted to other states depriving the under privileged population and hence, leading to regional disparity and non equitable growth.

It is well known that higher growth rate will come from the manufacturing sector only. Living standards will go up through infrastructure spending in the region. But all such projects require single large plot in a logical location. If in such location, a small plot of forest land or tribal land is included, the project implementation becomes difficult and finally, delayed or shifted. It means, the restrictive policy on the use of land is the basic reason for low or unequitable growth. Similarly, most of the mineral bearing land is under forest cover or inhabited by tribals. Hence, conducting mining operations on a large scale becomes difficult.

Recently, some activists have started raising concern over conversion of agricultural land to industrial land. If such laws are enacted, then any new investment will be difficult in other states which do not have forests or tribal population. It is also interesting to note that, several small plots of land having no tree or bushes have been categorised as forest land. These are all anomalies which need to be removed. Finally, government should come up with a land reform policy for optimum use of land. Restriction on use of forest land may be diluted with compensatory provisions, while restrictions on use of tribal land may be totally removed in the interest of tribals. Enhancement of agricultural activity on per acre basis is a better solution instead of enhancing the agricultural land coverage area. Responsibility of forestation should be shared by all states instead of burdening a few states only. Despite this, land acquisition becomes essential in some cases. Hence, land acquisition policy has to be framed with proper compensation to provide justice to the land owners and also to remove growth hindrances.

Subsidy reforms are the need of the day

Although every country has provisions for subsidy for needy and deserving citizens, unfortunately, in our country, these are being improperly used and implemented. Several studies have been done by the government in the past on subsidy reforms, but no action has been initiated. On the contrary, it is enlarging on a year-on-year basis. Total subsidy (including state / cross subsidy) will be exceeding 50 percent of the revenue which is ultimately financed by the borrowed funds. Thus, a holistic review is essential for the long term interest of the nation. If a portion of the subsidy is spent on rural / agricultural infrastructure, it will create earning opportunities for them.

Subsidy reforms are most essential. At the very outset, multiple schemes towards subsidy need to be merged, which otherwise lead to over subsidisation. Over subsidy is equally bad in comparison to no subsidy. Few subsidies like electricity, petroleum & food is even enjoyed by rich people which is highly unjustified. Hence, the census of under privileged persons may be done afresh with proper methodology. Cash transfer in lieu of subsidy could be a better solution, as being considered now by the government. The census list may be updated frequently and if the benefits of growth are seen as trickling down, as has been felt recently; then the list has to be pruned down in every revision. All this should be undertaken since the country's focus has to be on creating earning opportunities and to make everybody self dependent, having self respect, instead of depending upon government subsidy for life time without doing any work. However, old people, widows and the handicapped should be exceptions.

Energy reforms are a compulsion to match growth

Energy management is very vital to match desired economic growth. We have to enhance availability of energy resources and that too, by incurring low expenses. Self dependency in energy is highly important. Conservation and efficient use of energy is the requirement of day. Crude oil imports have gone up from 22 million tons (mt) in 1990-91 to 159 mt in 2009-10 over the last ten years. The indigenous production of petroleum has been almost static in the country till the recent entry of private operators. We are largely dependent upon imports. This leads to high trade deficit and drainage of foreign exchange reserves. With ongoing instability in oil producing countries, crude may touch a new peak of more than US$150 per barrel. This is likely to severely affect the growth target. Hence, the petroleum sector needs to be further opened up to promote entry of new private operators to enhance indigenous production. All regulatory hurdles may be removed. The government should provide incentives for exploration. Efforts may be carried out to partly replace imported crude by indigenous natural gas and bio-fuel. Commercial exploitation of coal-bed methane gas may be done as a partial replacement for imported crude. During the interim period, consumption of petroleum needs to be reduced. Investment in the public transport and railway may be increased to bring down the consumption. Subsidy in petroleum products may also be withdrawn in phased manner. At best, cash subsidy may be given to targeted users such as below poverty line (BPL) population.

We are also importing coal despite having huge coal reserves in the country. Coal sector needs to be further liberalised to increase production and to bring cost efficiency. Simple allotment of coal blocks is not sufficient. Facilitation for operating the coal block is essential. Land acquisition, environment norms and such other regulations are coming in the way of development in this sector. Coal blocks should also be given for merchant mining to fulfill the requirements of SME consumers and to create competition. This will also improve efficiency and help bridge the supply deficit. Captive coal block owners may be permitted to sale 25 percent of the production in open market till the demand supply mismatch is over. Competition in coal sector will unlock the hidden potential of the sector and shall improve efficiency as well.

Huge commercial loss in the electricity sector is to be reduced by fixing the responsibility with the distribution companies. Electricity tariff should not be revised unless absolutely necessary. Investment in distribution companies needs to be increased to adopt latest technology and to reduce both technical and commercial losses. Cross subsidy by industrial consumer to domestic consumer may be phased out and brought to NIL within the next five years. Subsidized rates to domestic consumer lead to higher electricity consumption which the country cannot afford. On the other hand, higher tariff to industry increases production cost and is passed on to consumer in round about manner.

Financial sector reforms need further boost

Several reforms have been already done in this sector, otherwise the growth in last ten years would not have been possible. But the reforms have to be part of an on going process, depending upon the circumstances and situation. For sustainable growth, savings to the tune of 35 to 40 percent of GDP is required to reduce dependency upon foreign savings. More important is to channelise the savings through financial intermediation so that funds are available to productive and infrastructure sectors. Physical saving, particularly in gold deposit, is to be discouraged. A large portion of savings is still in the form of cash at home (mostly prevalent in rural / suburban areas). This is a inert money which is not contributing to the growth of the country. It should be channelised through extension of banks in the rural/semi-urban sector. Perhaps, KYC norm also needs some relaxation. New account opening is becoming increasingly difficult on day-to-day basis. A practical approach has to be taken for this, to bring financial inclusion.

Financial resources mobilised by the bank are to be utilised in the productive sector. SME sector in particular is deprived of the credit from the bank as well as mobilisation of equity from capital market. This needs attention. Micro finance activities should increase, so that small farmers, small enterprises have an access to the capital. Interest subsidy to the small farmers announced in the budget is the right way of subsidy. Personal loan/consumer finance needs trimming down except housing and educational loan. Corporate debt market is to be activated so that SME gets space in the bank finance. Other wise also, banks cannot meet the requirement of large infrastructure spending in the country, hence debt market shall be useful. The interest rates need to be trimmed down as the present interest rates are deterrent to fresh investment and a big hurdle to growth.

Share of capital market investment is still very low, which otherwise, provides long term risk capital. This is to be increased through fiscal incentive like reduction of dividend tax. Volatility is to be reduced by increasing margin on 'futures and options' and reducing circuit filter limits. Calibrated exposure of pension and insurance fund may be permitted into equity market as being done in the developed countries. Role of mutual funds is to be enhanced.

Outlook

The 9 percent growth target this year is in itself a challenge., given the high crude prices and inflation problems till date. Excess regulations promote corruption and become hurdles for investment. Hence, regulators have to refrain from activism. Our country therefore, needs a big dose of reforms as was done in 1991 in lieu of populist measures. Inclusive governance is the key for all reforms. ■

R.P. Gupta, B.Sc. Engg., Vice Chairman – Orissa Assembly of Small & Medium Entrepreneurs, Cuttack; Advisor – OJC (Orissa, Jharkhand, Chhattisgarh) Chamber of Commerce & Industry; Ex-Vice President, All India Mini Cement Plant Association, Hyderabad

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