



A Grin Without a Cat

I've often seen a cat without a grin," thought Alice; "but a grin without a cat! It's the most curious thing I ever saw in all my life!" (Lewis Carroll, "Alice's Adventures in Wonderland"). Such was the feeling of wonder amongst many discerning Indians when Finance Minister Pranab Mukherjee unfolded the budget document for the year 2011-12 in the country's Parliament earlier this year.

The Minister's Bizarre Smile

It was surprising to note the generous increases in social sector spending viz. health, poverty alleviation, employment guarantee schemes, agriculture, subsidized grains and fertilizers, education, women welfare, arts, culture, rural development and housing. As the focus shifted from Expenditure to Income, analysts were taken aback by the absence of any significant new taxes. In fact, there were some reductions in customs and excise slabs. "Here we go", said the experts, "we are in for a sharp increase in the Fiscal Deficit and, consequently, an increase in printing of new money (and/or higher government market borrowings)".

As the reading continued, the Minister's attitude continued to resemble the Grin in the legendary Lewis Carol story – one could actually sense the good man's happiness as he went about the annual ritual unfazed and confidently. And lo behold! There was actually no increase over the previous year in the government's borrowing budget. And finally, the fiscal deficit had not only not increased as widely feared, it had actually come down substantially from the budgeted 5.5% of previous year to a proposed 4.6% in the new financial year. <http://exim.indiamart.com/budget-2011-12/budget-glance-2011-12.html>

And the crowning glory was yet to come. There was this very pleasant disclosure by the Minister that India's public debt was slated to come down from around 55% of GDP in the previous year's budget to a projected 44.2% of the GDP in the ensuing year. So much for the doomsday predictions of a debt trap. <http://exim.indiamart.com/budget-2011-12/pdfs/bs.pdf>

The Smile Explained

Ninety minutes later, when Mr. Mukherjee commended the budget to the august House, economists and politicians alike rushed to unravel the mystery behind these numbers. Many of them jumped the gun by proclaiming that the revenues were unattainable and that the government would have to borrow a lot more than the budget projections. Stock markets and Bond markets gave the thumbs down to the budget. Yet the grin remained - without the cat.



As the number crunching continued, the true story was revealed in an article by Rishi Shah in the Economic Times dated March 08, 2011. It appears that India's GDP at current prices is rising by a stupendous 20.3% in the year ending March 2011. And it is projected to rise by another 14% in the year 2011-12. An increase of 35% in two years is sure to have sent the tax revenues soaring. And over the past five years, it would have gone up by a stupendous 127%. Therefore, the Government's tax revenues have been shooting up at a faster than the customary rate. <http://indiabudget.nic.in>

Inflation: The Villain Turned Hero

And while it is true that India's GDP is also growing quickly by 9.6% per annum, the Minister (and the Government) must be silently paying obeisance to the so called curse on development viz. Inflation. The high inflation of the current year of around 9% and a similar figure of 8% a couple of years ago has unshackled the Government's hands as never before. The high growth high inflation syndrome has let the Government spend more and more on social sectors without fearing a high fiscal deficit or a debt trap. In fact, like all general Debtors with fixed rate borrowings, the Government has actually reaped the benefits of high inflation.

This brings us to the crux of the matter. I have pointed out in my earlier article "Farmer in the Dell" <http://econintersect.com/b2evolution/blog2.php/2011/02/17/the-farmer-in-the-dell> that high food inflation is bringing about a change for the better for the poor Indian farmers who form over 60% of the population. Now we see the Government of India also getting inflationary benefits as many of its expenses like interest payments, social spending in absolute terms etc. are not inflation linked. Indian manufacturers, like their counterparts the world over, have always tried to milk inflation to the fullest to their advantage through their pricing policies. Civil servants, who form a good part of the work force, get generous inflation/dearness allowances. Thus, other than the main sufferers, the urban poor and lower middle class, inflation appears to be spreading quite a lot of genuine happiness all around.

Inflation needs a fresh look

It is not the author's intention to be frivolous and turn a proven convention on its head and make a hero out of rising prices. It is only an attempt to draw attention to this strange situation in India and coax policy makers (including the central banking authority) and pure economists to delve further into this paradoxical state of affairs. This would help them to either firm up further their respective anti-inflationary mind-sets or give them the required leeway to moderate their targets on the rate of inflation. India is on the verge of taking, nay, has already taken the great leap forward and policy makers need to proceed with caution with their tightening stance which could result in a hard bumpy landing in the middle of nowhere. We have already seen the annual Index of Industrial Production fall to 3.7% from a high of 16.5% a year ago. <http://www.rttnews.com/Content/TopStories.aspx?id=1573471&SM=1>



Let us not allow the tightening cycle to become a noose around the neck of economic development. Let us permit the invisible cat to grin some more.

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<http://econintersect.com/b2evolution/blog2.php/2011/03/26/a-cat-without-a-grin>

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