

Budget 2018: Why Narendra Modi government should focus on policymaking, not policing

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The target was the illegal. The bullet hit the culprit, but also a bystander – the informal. He was caught off guard, could not dodge the bullet, and was badly crippled. His recovery is slow. The culprit also sustained significant injuries, but they are not life threatening. He is currently lying low. This, in a nutshell, is a story of two key government policies of demonetisation and implementation of the GST.

In both the cases innocent bystanders, well-intentioned legitimate businesses and the millions of Indians working in the informal sector, were hit hard. Is this justifiable that so many bystanders are affected when the bullet is fired by a cop himself? Was the cop, the policymaker, ill prepared? Was the bullet, the policy itself, faulty? Or was it a case of a mistaken identity, confusing the informal sector with the illegal one? Let us investigate.

Demonetisation entailed a surprise ban of Rs 500 and Rs 1,000 notes. In this case it has been clear from the start that the bullet itself was faulty. The initial aim was to go after the hordes of illegal cash held by a few, but in the process, millions of Indians, who for their daily living depend on perfectly legal cash, were forced to go through excruciating and unanticipated pain.

The aim may be sincere and honourable, but is shock and awe tactics desirable when the cop fails to pick the right ammunition to fire? Should a policy which would eventually affect almost every single citizen and make over 85 percent of legal tender suddenly worthless, not have required collecting more evidence and careful think through?

As far as the GST is concerned the ammunition, the policy, is indeed appropriate. The aim was double-fold: First, bring millions of businesses into the tax net and thereby raise tax collection. Second, improve the efficiency of the production process and lower cost of doing business for entrepreneurs.

GST removes the discrepancy between indirect taxes among different states, streamlines business records and tax payment systems, reduces the overheads such as logistics costs and eventually should result in more economic activity. The policy shift was long over-due and much needed. But, was there a case of a mistaken identity that left the cop unable to judge the disruption that its policy implementation will create?

Most of the Indian businesses are in the informal sector and employ over 70 percent of total workforce in the economy. Agreed that we need to lower tax evasion in the informal sector by creating incentives to improve the compliance. If voluntary compliance is not rising, the policymakers need to raise it forcefully.

But when would the force work with the least amount of disruption to the society? By putting in place a less cumbersome system for relatively tech non-savvy small scale businesses to record their transactions and pay taxes. The preparedness of the informal sector businesses to cope up with a regime shift is very different than that of businesses in the formal sector. The policymakers perhaps misjudged this impact. Now we have a court-like system, GST anti-profiteering body, to investigate if boons of lowering of tax under GST were passed on by companies in terms of lower prices to consumers.

Now, if the retail outlet such as Lifestyle does not lower their prices in response to a lower tax rate, but if people continue to flock to the shop, why should the company lower the price? And if enough people aren't purchasing their goods, wouldn't firms automatically lower the price or offer discounts? Should the government interfere in the pricing of private goods and that begs a related question too, do we still need the MRP law?

In another policy move, a ban was announced on charging prices higher than the government prescribed limit for knee implants and cardiac stents. Apparently, there is a talk of another 20 medical devices to be brought under the price cap. While on the face of it, these might appear to be welfare-enhancing policies, such policing of an industry rarely works giving rise to a number of unintended consequences.

Another key policy of the government is the Swachh Bharat Abhiyan with an aim of making India open-defecation free. The government is keeping a watchful eye on the progress of this noble initiative in terms of number of toilets built, but will building toilets solve India's sanitation problem? What about the access, usability and maintenance of toilets, especially when there is a severe shortage of piped water in most places?

The biggest lesson in economics and policy making is that good intentions can have unintended consequences. The government policies and programs should not be judged by the intentions, but by their outcomes, so said Milton Friedman, the Noble laureate economist.

The government has already announced that rural India and infrastructure as the focus areas in the upcoming [budget](#). Numerous earlier [budgets](#) from different political parties have had the same focus, but little impact. What matters for the success of policy initiatives is that they create right incentives for all stakeholders and improve their decision making. Public policies should reform, and not raid. Hopefully, the policymakers will keep this in mind while framing the next budget.

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