Budget 2011: Dismantling the TINA Policies

The TINAs failed in fixing the flaws in the country's hardware -- its physical environment and an efficient system for developing it. The signs are everywhere: in energy, transportation, ports, and telecommunication. If they were not competent to optimize the allocation of our resources, undermining the economy's medium- to long-term growth prospects, they could at least have allowed the population to enjoy the consequential benefits of lower budget deficits

-- Mohun Kanhaya

We were among the ones who did not applaud when the TINAs (There Is No Alternative), moulded by the infamous "triple shocks", ushered in their new socio-economic model that promised us a new phase of sustained, broad-based growth and full employment but ultimately failed to deliver on our economic, social and environmental goals. We were equally sceptic when they unravelled their neo-liberal and purely theoretical policies -- the reduction of subsidies on rice and flour but without the liberalization of the prices; the hasty implementation of NRPT without adequate preparation and without careful thinking on the various implications of the new tax; the taxation of interest income; the introduction of a flat tax that replaced a progressive income tax system by a regressive one and allowed the better-offs and the corporate sector to capture all the gains of our generous taxation policies -- in other words, a typical IMF one-size-fits-all approach that did not reflect the local expenditure and savings needs and incentives realities; the setting up of a CSR Fund that gave a free hand to companies to implement their own approved CSR programmes which turned out to be more of a mess than a substitute for public redistributive policies and the launching of the Loto and the abnormal zealousness to issue gambling licenses.

Budget 2011 deals a lethal blow to many of these TINA policies while exploring new paths to an endogenous inclusive development. Budget 2011 carves out some decisive moves towards an alternative development paradigm that recognizes the importance of providing ourselves with the means to realize our vision of becoming a more diversified services and knowledge-based economy as well as economic security and diversification to widen the economic base required for long-term sustainable growth. It has also vindicated our doubts on the TINA policies. While the TINA stooges in the press and in the private sector were building up the TINA-wallahs and their friends as the most brilliant and super competent economists that ever walked on Mauritian soil, we have, in the very columns of this paper, maintained a consistent opposition to their ruthless neo-liberal policies that wreaked havoc on our values of generosity, solidarity and community.

The widening income inequality that was shrugged off when economic times were good has become intolerable in the slowdown. The gaps between rich and poor have exacerbated. The successive TINA budgets amassed huge revenues and generated unacceptable inequalities. The TINA policies did not succeed in diversifying the economy and in developing other pillars that would have rendered it more resilient to external shocks. They have, however, attracted massive resources into real estate activities whose contribution to the economy is questionable. Land prices have risen beyond the reach of most Mauritian households, while sugar barons extracted huge profits on their large property holdings, but contributed marginally to taxation. The middle classes were made to pay higher property taxes -- the infamous NPRT -- while corporate tax was slashed and huge promotion budgets were given to the tourism sector, and most importantly, the EU compensation money for the restructuring of the sugar industry went to the sugar barons, instead of supporting those who had shed their sweat and toiled for decades to enrich these barons. The TINAs also pressed in favour of the depreciation of the rupee to boost sugar and other export revenues of the oligarchy, while the population, especially the poor, had to bear a rather high inflation burden. Budget 2011 aims instead at rebalancing the relationship between the different stakeholders of the economy for a fairer and more equal distribution of the national cake.

Tax Reform: Budget 2011 has brought in an element of progressivity in personal taxation as income earners above Rs 2 million will be charged 10 percent on their exempt income. It has also removed the tax on interest income in line with our arguments that a progressive tax structure with limited taxation of savings would be a better tax system. The TINA-inspired tax regime was unable to comply with the other main canons of a good tax system – fairness (based on ability to pay) and equitable (decrease of tax distortions for the couple). It had eliminated the possibility of any tax planning by taxpayers for the medium-to-long-term. Taxpayers earning more than Rs 25,000, especially the middle income earners, were imposed a relatively higher burden of the new tax.

Inequality increased slightly with the imposition of the TINA tax regime whereas the previous regime showed signs of progressivity, taking a greater share from high-income earners and a smaller share from low-income earners. The reintroduction of deductions for first-time home owners and for those taxpayers investing in the education of their children will encourage our taxpayers to plan for a better future. The middle class, which has to substitute for an ineffective State in investing in the higher education of its children and thus ensuring that the country is provided with the necessary qualified human resources of international standard to meet its needs, is thus being compensated. On the issue of the taxation of savings, we have consistently maintained that standard bank accounts should be entirely free of tax for they represent the risk-free or 'normal' return to saving as compared to other holdings of risky assets that tend to have returns above the 'normal' rate and thus subject to tax.

Corporate Social Responsibility: The TINAs introduced a flat tax on personal incomes as a way to simplify the tax system and increase compliance. It replaced a system within which income tax rates vary from 15% to 30%, but which also contains many concessions. The philosophy of the tax was either charging a high tax rate accompanied by numerous concessions and preferences or a low tax rate without any tax-free minimums or deduction of inherent expenses from the taxable amount. There were also arguments that the lowering of the corporate tax rate would render the investment climate more attractive, especially in our quest for foreign direct investment. The commercial banks saw their tax liability go down by 15% and they thus reaped enormous profits which generated a huge outcry against the regressive flat tax. The anti-TINAs were scoring too much and the TINAwallahs were losing too many feathers in the political arena. They had to do something to give a semblance of correcting their private sector bias. A solidarity levy was thus imposed on the profitable banks; this was increased to 1% of turnover and 3.4 % of profits – the 1% of turnover is equivalent to 6 to 8% of corporate tax. Moreover, the profitable companies have to spend 2% of their profits on Corporate Social Responsibility activities approved by government or alternatively transfer the funds to government to be used in the fight against poverty. The CSR Fund turned out to be a mere "tick the box" approach which defeated the spirit and intent of the concept of Corporate Responsibility, without necessarily leading to any better outcomes. It was also fast acquiring a peculiar nasty ethnic overtone, for the potential beneficiary has to carry his begging bowl all around the corporate world looking for potential sponsors and seeking their consent for financing his project. And who is not aware of the prejudices and the ethnic demarcations/compartments of our private sector? Budget 2011 corrects this to some extent by repossessing 50 percent of the CSR resources to focus on three national Programmes, namely Social Housing, Welfare of Children from Vulnerable Groups and the Eradication of Absolute Poverty.

Recommendations

(a) In addition to the new measures taken in Budget 2011 to widen the tax base, more revenue raising efforts should be made, especially from the larger companies, by a closer review of their accounting practices. The corporate sector fails to bear its fair share of the burden, on account of its opaque accounting practices that shield the true extent of its profitability -- missing accounting policy disclosures, absence of consolidated financial statements of sociétés, inappropriate depreciation methods, disclosures about related parties and related party transactions, limited disclosures about valuation. A strengthened Financial Reporting Council (FRC) would be able to tap these sources of revenue.

(b) Increase investments and continue providing more room for capital spending, while restraining current spending to limit the overall fiscal deficit. The price paid for the welfare state, among others, has been deficient infrastructure. Capital expenditures should reach at least 5% of GDP, and the implementation of capital projects upgraded to ensure that budgeted amounts are actually spent, and project outcomes delivered. The Project Design and Monitoring Unit should be supported by a multidisciplinary Delivery Unit, under the direct responsibility of the VPM and Minister of Finance, which will ensure that necessary steps are taken to reform the system in the right sequence and with the right rigour for the implementation of some 20-25 priority capital projects,

(c) Start reviewing the provision of ‘free’ health, education and other public services in a long-term plan, and bring about greater public accountability, while exempting lower income groups,

(d) Improve civil service efficiency and productivity, especially through a fair, open and transparent recruitment process and the High Level Committee, in addition to establishing a national policy and strategy, should also propose a revised HR remuneration structure to attract top-notch skills. (The question of the PSC delegating recruitment and promotion authority to Ministries and Departments for technical and managerial staff seems to be another *croc-en-jambe*, like the discredited Discussion Paper of the National Tripartite Forum, which will only serve to open the Pandora's box giving free rein to the occult forces to ruin our Civil Service), and

(e) Strengthen the framework for PPPs to encourage more infrastructure investments.

Creative Accounting and the Special Funds

Budget 2011 also meets the commitment to remove some of the opacities about the Special Funds and integrate all these funds that were proliferating all over the place into the budget for better expenditure coordination, accountability and transparency. The inflows and outflows of these special funds, that are given at Appendix I of the Programme-Based Budget Estimates 2011, allow us to uncover some of the creative accounting carried out over the past four years and arrive at the true budget deficit figures. The creative accounting (an American euphemism for "cooking the books" very popular with journalists endeavouring to cover up for their "friends" in corporations like Enron and others) and the creation of special funds originated with the IMF comments on the 2007/07 budget -- "*The budget deficit target for this fiscal year is in reach, but the adjustment mix is unfavorable — almost half of the expenditure adjustment relates to lower capital expenditure*." That has been the whole story since: the underperformance in capital expenditure. All kinds of creative accounting were used to try to hide the poor implementation of infrastructure projects. With the over-taxation of the population, we did not have a revenue but a spending problem -- the low capital expenditure as from the first budget. Thus in 2007/08, 2008/09 and Jul-Dec 09 , Rs 3.1 billion, Rs 5.6 billion, Rs 2.5 billion respectively were transferred to the seven funds listed below. A total amount of Rs 11 billion was surreptitiously included in Budget estimates as expenditure, mostly capital expenditure. (We have not taken 2010 figures because it includes the ERCP.)

Allocation to Seven Special Funds

Fund (Rs million)	**2007/08**	**2008/09**	**Jul-Dec 09**
Food Security Fund	1000		
Human Resource, Knowledge and Arts Development Fund	1000		
Local Infrastructure Fund	130	375	700
Saving Jobs and Recovery Fund	-	3150	
RDA-LTA		1000	1750
Maurice Ile Durable Fund	1000		
Social Housing Development Fund		1100	
Total (Rs million)	**3120**	**5625**	**2450**

Expenditures from the Funds

Funds (Rs million) *Amount Spent*	**2008/09**	**July-Dec 09**	**2010 Estimates***	**Total**
Food Security Fund	9	55	14	78
Human Resource, Knowledge and Arts Development Fund	42	61	69	172

Local Infrastructure Fund	-	154	159	313
Saving Jobs and Recovery Fund	212	243	712	1167
RDA-LTA			324	
Maurice Ile Durable Fund	103	205	78	386
Social Housing Development Fund	382	99	19	500
Total (Rs million)	748	724	1365	2940

The 'Expenditures from the Funds' Table shows that as at Dec 2009 only Rs 1.5 billion (Rs 748 million in 2008/09 and Rs 724 million during July-Dec 09) were spent from these funds totalling Rs 11 billion. Reworking the budget figures by including only what has been spent from these funds rather than the whole amount of the funds, the budget deficit turns out to be a mere -1.5% for 2007/08, -1.3% for 2008/09 and -2.8 for July-Dec 09.

As a % of GDP	**2007/08**	**2008/09**	**July-Dec 09**
Budget deficit	-6906	-8445	-5841
Budget deficit (*Without colorable accounting)*	-3786	-3568	-4115
Budget deficit	-2.7	2.5	-4.0
NEW Budget deficit	-1.5	-1.3	-2.8

For much less than such manipulation, one Finance minister was hounded by the mainstream press and the erstwhile opposition and had to resign. These shifty tricks that were carried over three budgets have had very serious economic consequences. The true picture was hidden from the population and more seriously it meant a total failure in the management of public finances, which had their implications on interest rates, the current account, exports, growth, and the level of public debt. The parking of Rs 11 billion in bank accounts has had a huge opportunity cost. At least if we had been drawing regularly from these funds we could have had some excuses for such poor fund management. The higher than actual budget deficit figures led to higher level of interest rates, higher debt servicing, higher burden on exporters, a higher current account deficit and lower growth. And these were the same people who were pointing fingers at the Governor of the Bank of Mauritius for maintaining a relatively high level of interest rate. And the Governor in the face of strong capital inflows was demanding more of fiscal restraint -- *“Le gouverneur de la Bank of Mauritius (BoM), Rundheersing Bheenick, demande l’aide de l’Etat mauricien pour la maîtrise du flux de capitaux étrangers à court terme qui submergent le pays. A travers son budget, mais également à travers les institutions sous son contrôle, l’Etat est exhorté à faire un plus gros effort afin d’aider à annihiler les effets néfastes. »*

It is beyond understanding why the fiscal space generated over these three budgets was allowed to lie lamely in bank accounts. It would have been more logical to show lower budget deficits and borrow from the market whenever there was a need for additional funds for the implementation of capital projects. What’s more mind-boggling and scandalous was that over the same period some Rs 45 billion of external borrowings (out of which only Rs 5 billion were utilised) were contracted, sometimes at unreasonable above-average market rates. Capital expenditure as a percentage of GDP, without the accounting gimmicks in the three budgets, barely exceeded an annual average of some 3%. Such a dismal investment performance choked off economic growth by limiting public investments in key sectors. The TINAs failed in fixing the flaws in the country’s hardware -- its physical environment and an efficient system for developing it. The signs are everywhere: in energy, transportation, ports, and telecommunication. If they were not competent to optimize the allocation of our resources (for e.g. the LRT could have started back in June 2008), undermining the economy’s medium- to long-term growth prospects, they could at least have allowed the population to enjoy the consequential benefits of lower budget deficits.

Mohun Kanhaya