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The stock market once again reacted to the Budget with irrational pessimism, as it had done during the interim budget. When Pranab Mukherjee started his Budget speech, the Sensex was up 150 points and by the time he finished, it had declined 756 points, a total decline of as much as 6 per cent. Possibly some unwarranted expectations were not realised, and the market reacted prematurely. In fact, Mukherjee has done a pretty good job in delivering on the mandate to restore high growth and promote equity without recourse to undue fiscal profligacy. Despite this, the Budget has a very large deficit of 6.8 per cent of GDP and fiscal consolidation will be his main challenge going forward.

The mandate for inclusive growth will be met primarily through the expenditure programme. Much of the incremental expenditure will be allocated to rural inclusiveness programmes like the NREGA, implementation of the proposed National Food Security Act, the National Rural Health Mission, rural infrastructure schemes under Bharat Nirman, and other major infrastructure projects such as highways, ports, airports, power, urban renewal, etc. All these have high multiplier effects on aggregate demand and will continue the strong impetus to restore growth.

The expenditure programme will be financed to the tune of Rs 6.15 lakh crore through revenue receipts, including tax revenue totalling Rs 4.7 lakh crore (net of devolution to states). No major developments here. The finance minister has been careful not to tamper with the basic rate structure of direct and indirect taxes despite much lobbying by special interest groups. On the indirect taxes side there is some rationalisation.

The main announcement of general interest here is the commitment to introduce the Goods and Services Tax by April 2010, but there is some doubt whether the government will actually be ready to do that. In the case of direct taxes a few announcements have been very well received: withdrawal of the 10 per cent surcharge, withdrawal of Fringe Benefit Tax and raising of tax exemption limit. The corporate sector is naturally less pleased about the Minimum Alternate Tax rate being raised to 15 per cent of book profits.

A Direct Taxes Code will be announced in 45 days. Apart from tax receipts and other non-tax revenues, another major source of financing on which there were great expectations is divestment of PSU shares and sale of wireless communication spectrum. However, Mukherjee has kept his options open on this item barring a small provision of Rs 1,120 crore, mentioning only that a majority government holding of 51 per cent shares will be maintained in PSUs and that there will be no divestment in public sector banks and other financial institutions. It is reasonable to expect that later in the year we may see some significant developments on this front.

Pending the announcement of a substantial divestment programme, there is a central government fiscal deficit of Rs 4 lakh crore or 6.8 per cent of GDP to be almost entirely financed by market borrowing. Additionally, state governments have been allowed a total borrowing programme amounting to 3.5 per cent of GDP (4 per cent of SDP), thus taking the total national fiscal deficit to around 10.5 per cent of GDP allowing for some off-Budget borrowing for oil companies etc. The implications of this large deficit is the main risk arising from the current Budget. There is already enough liquidity in the credit market and the RBI can further support this through open market operations, so it is unlikely that private investment will be crowded out through upward pressure on interest rates.

However, servicing an additional public debt of nearly 20 per cent of GDP added during the last two years imposes a huge pre-emptive claim on future spending, with a real risk of crowding out public investment on infrastructure and social overheads like education and health. The risk of higher inflation is low at present. However, no complacency is warranted on the price front given the recent hardening of oil prices and the possible adverse impact of a weak monsoon on food prices.

Against this background, it is comforting that the finance minister has emphasised the need for fiscal consolidation in line with the Fiscal Responsibility and Budget Management Act as soon as feasible. Though a full fiscal consolidation programme will have to await the recommendations of the Finance Commission by October, the ministry's Medium Term Fiscal Policy Statement indicates that it intends to reduce the deficit to 5.5 per cent of GDP by 2010-11 and further to 4 per cent by 2011-12. Its seriousness of purpose is borne out by the compression of three major subsidies on food, fertilisers and oil from Rs 2.2 lakh crore or 4.1 per cent of GDP in 2008-09 to Rs 1.2 lakh crore or 2 per cent of GDP in 2009-10. Clearly, the finance minister is seeking a medium-term strategy to deliver on the mandate for inclusive growth without compromising on fiscal sustainability.

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