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Fuelling The Growth Story

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Barring the histrionics of a strident opposition increasingly lost in the wilderness, virtually all sections have welcomed the budget. All sections, that is, of the visible and vocal minority. As for the silent majority, they are well silent, but more on that later. The BSE stock price index went up 300 points even before the finance minister finished his speech. Pranab babu has done all the expected things the market had factored in plus some, hence the gain. With the economy growing at 7.2 per cent, he has started winding down the fiscal stimulus in a calibrated manner. How is this to be accomplished?
Tax revenues are to go up to Rs 5,34,000 crore and non-tax revenues are to go up from Rs 1,12,000 crore to Rs 1,48,000 crore, mainly on account of 3G spectrum sales. This will raise total revenues to 9.8 per cent of a projected GDP of Rs 69,35,000 crore in 2010-11, up from 9.3 per cent of GDP in the revised estimates for 2009-10. Capital receipts other than loan recoveries (mainly sale of public sector equity) will yield Rs 40,000 crore or 0.58 per cent of GDP as compared to 0.42 per cent last year. Thus additional revenue and non-debt capital receipts will reduce the fiscal deficit by 0.7 per cent of GDP. On the expenditure side, capital expenditure will rise to Rs 1,50,000 crore or 2.16 per cent of GDP, an extra 0.3 per cent of GDP compared to 1.86 per cent last year. However, revenue expenditure will be compressed to Rs 9,59,000 crore or 13.83 per cent of GDP compared to 14.66 per cent last year, yielding an additional reduction in the fiscal deficit of 0.5 per cent, i.e., a total compression of the fiscal deficit by 1.2 per cent from 6.7 per cent last year to the targeted 5.5 per cent this year.

Tax revenues will rise despite significant relief in income tax rates for personal incomes below Rs 8 lakh and a reduction in the surcharge on corporate income taxes. On balance the reliefs will entail a revenue loss of Rs 26,000 crore on the direct taxes side. This will be more than offset by a revenue gain of Rs 46,500 crore in indirect taxes. The indirect tax take will go up mainly on account of the expected partial rollback of excise duty reductions, a one per cent clean energy cess on domestic and imported coal, etc. The excise duty rate, the peak customs duty rate and the service tax rate have all been set at 10 per cent, preparing the ground for introduction of a unified Goods and Services Tax next year. This, along with the Direct Taxes Code, will usher in a new phase of thorough tax reform. However, an opportunity has been lost in not significantly extending the coverage of the services tax. Also, the indirect tax proposals are still full of discretionary exemptions, concessions and specific rates for individual items, which are reminiscent of the pre-reform days.

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Tax reforms will be combined with a new commission to oversee significant reforms in the financial sector, licensing of new banks and another commission to monitor large corporations that could pose systemic risk as seen in the advanced countries during the financial crisis of 2008-09. Announcement of a substantial reform programme, along with fiscal consolidation, and the protection of capital expenditure on infrastructure while compressing revenue expenditure, makes the current budget a very sound budget for growth.

However, the budget has been quite conservative on the inclusion agenda and social programmes, which are mostly items of revenue expenditure. Thus, total spending on the flagship inclusion programme NREGA, now renamed Mahatma Gandhi National Rural Employment Guarantee Scheme, has remained essentially constant at Rs 40,100 crore in nominal terms compared to Rs 39,100 crore last year, which means a decline in real terms. It's the same story if you take the total spending programme on rural development, or agriculture, or school education and literacy, or women and child development, or health. In all these social inclusion programmes, the expenditure levels have been maintained at more or less the same nominal levels as last year, meaning a decline in real terms.

This is not surprising coming from an experienced finance minister. This being the first year of the UPA II political cycle, he knows he has only this year and the next to push through all the hard-nosed reforms and fiscal discipline that are important for sustaining high growth. After that, inclusive spending will start galloping in response to political compulsions as elections loom large on the horizon, and fiscal discipline will fall by the wayside.

It also has to be mentioned that there is a whole different approach to inclusive growth outlined in this year's Economic Survey, which proposes revolutionising the delivery of social services and anti-poverty programmes, making them more effective and leakage-proof through a coupon based system instead of just throwing more money at them. The finance minister has hinted

that he is buying into this approach. We will hopefully see far-reaching reforms not only on the growth front but also in the approach to inclusiveness over the next two years. So all is not lost for the silent majority after all.

The writer is Emeritus Professor at the National Institute of Public Finance and Policy, New Delhi.