Playing The Growth Card

Constrained by economic circumstances, the finance minister has made the best of a poor hand

Sudipto Mundle

The 2012-13 Budget is a realistic attempt to resume fiscal consolidation, while also seeking to restore high growth.

It has been crafted under challenging conditions. Inflation has come down, but price pressures remain, especially the Iran situation and oil. There is recession in EU countries and Japan and slow growth in the US. At home, growth has slid below 7%, and the fiscal deficit ended up at 5.9% instead of the planned 4.6% of GDP.

Against this background, the finance minister could not credibly claim that he would stick to the earlier deficit target of 4.1% for 2012-13. Instead, he has said he will get the deficit down to 5.1 %, with a medium-term roadmap for further reduction. More importantly, he has provided specific expenditure and revenue measures which will help him meet the target.

He is also introducing an amendment to the Fiscal Responsibility and Budget Management (FRBM) Act that will make fiscal consolidation mandatory. This should give comfort to the markets, investors and the monetary policy authorities that he is realistic, but also serious about fiscal consolidation. For financing the deficit, the central government plans to borrow Rs 4.79 lakh crore from the market, an increase of 10% over last year's market borrowing.

On the downside, the Medium Term Fiscal Policy Statement terminates with a 3.9% fiscal deficit and 2% revenue deficit in 2014-15 instead of the original FRBM Act targets of 3% and 0% respectively. Have those targets been abandoned, or just the timelines shifted? Also, what will happen if the proposed expenditure targets are overshot, or revenue receipts fall short, as happened in 2011-12? Would that translate to a larger deficit? There is no clarity on these key questions.

The fiscal consolidation effort is split between expenditure and revenue measures. On the expenditure side, total spending is to go up from Rs 13.2 lakh crore to Rs 14.9 lakh crore, an increase of 13% as compared to an expected 14% growth in nominal GDP. That implies a mild compression. However, in the allocation of expenditure, there is a large increase of 25% in plan capital expenditure from Rs 80,4000 crore to over Rs 1 lakh crore, and an increase of similar order in defence and other non-plan capital expenditure. Thus, the entire burden of compression is to be absorbed in revenue expenditure, especially non-plan revenue expenditure.

> If the Budget assumptions are validated, and the revenue and expenditure targets hold, fiscal policy will be back on the path of consolidation, while also helping to revive growth

Waiting to exhale: Will the Budget bring relief to a sputtering economy?

In other words, expenditure compression is being combined with a sharp increase in capital expenditure on infrastructure and other capital formation. Taken together with details of expenditure allocation and specific relief given in indirect taxes, this adds up to a consistent strategy for reviving investment and growth along with fiscal consolidation

Particular items of expenditure allocation are interesting. The budget for major subsidies has been slashed by 12%, with the intent of containing it at less than 2% of GDP. At the same time, the minister has announced that the subsidy requirements for the pending food security Bill will be fully financed. This implies the cut will fall entirely on petroleum products and fertilisers. Expect a significant increase in fuel prices, including possibly diesel and LPG, post the budget session.

Similarly, the central plan outlay on social services, including education and health, is to increase by 21%. But allocation for rural development is to increase only by a little over 5%, meaning a reduction in real terms after allowing for inflation. Moreover, within rural development, the allocation for MNREGA has been cut from Rs 40,000 crore last year to Rs 33,000 crore this year, while that for the Pradhan Mantri Gram Sadak Yojna has been raised from Rs 20,000 crore last year to Rs 24,000 crore this year. Thus, even for welfare and social spending, the emphasis is on productive spending on human development and capital formation rather than pure anti-poverty programmes.

Turning to the revenue side, there are only marginal changes in direct tax provisions, pending introduction of the Direct Tax Code later this year. However, there is a major reform in shifting the services tax base from a positive list to all services barring a negative list of 17 items. There is also an increase in the service tax rate to 12%, harmonised with a similar increase in excise duty rates from 10% to 12%, with commensurate increases in lower excise slabs. These lay the ground for eventual introduction of the Goods & Services Tax, the second major plank of pending tax reform.

Customs rates have not been changed, but there are customs and excise concessions for specific items, mostly to encourage infrastructure investment and revival of stressed industries like textiles. On balance, there is a net revenue loss from relief in direct taxes amounting to Rs 4,500 crore, while the collections from indirect taxes, including additional revenue measures, will increase by Rs 45,940 crore, leaving a net tax revenue gain of Rs 41,400 crore.

Non-tax revenues are budgeted to increase by a whopping 32%, from Rs 1.25 lakh crore in 2011-12 to Rs 1.65 lakh crore. This is mainly on account of a large provision of Rs 58,217 crore for 'other telecommunication services', presumably implying resale of 2G spectrum.

If the Budget assumptions are validated, and the revenue and expenditure targets hold, fiscal policy will be back on the path of consolidation, while also helping to revive growth. The Budget is a job well done under difficult conditions.

The writer is emeritus professor at the National institute of Public Finance & Policy, New Delhi.