Hype and Reality of Ten Lakh crore Budget

Sudipto Mundle

As the Finance Minister presented his Rs. 10 lakh crore budget the Sensex fell 900 points, wiping out 6 % of total market valuation in just over an hour. This is unfortunate because the budget is primarily a hard nosed program for pump-priming high growth, with a special focus on infrastructure, and added elements of inclusiveness. There is also a clear commitment to fiscal consolidation in the medium term and many indications of the reforms that are likely to be launched during the year. However, all this has been lost in the packaging and the budget has become a victim of its own hype.

As this newspaper put it on 7 July, the budget has been perceived as a budget for Bharat and that has spooked the markets in India. There are indeed many components in the expenditure program- some large and some small - to support the rural sector, especially the rural poor, and other weaker sections of society. By detailing each of these components, however small, and claiming massive increases for many of them compared to the Budget Estimates of planned spending in 2008-2009, the budget speech conveyed the impression that it is mainly about supporting the rural poor and other disadvantaged groups. However, the reality is that the revised estimates of actual spending in 2008-2009 exceeded the initial Budget Estimates by a whopping Rs. 1.5 lakh crores. Compared to these Revised Estimates of expenditure in 2008-2009 the main thrust of increased allocations in 2009-2010 is on different items of infrastructure, not on the inclusiveness components.

To illustrate, allocation for NREG - the flagship inclusiveness program - has been raised to Rs. 39 thousand crores, an increase of 10%, while the allocation for rural development as a whole has been increased by 7%; and that for agriculture and allied activities has been increased only by 6%. The total allocation for irrigation and flood control for the entire country is only Rs. 439 crores. Similarly, in social services the allocation for education has been increased by only 4 %. Compare that with a 41% increase in the allocation for power, and a total allocation of Rs.116 thousand crores for energy has a whole, marking an increase of 17%. The allocation for transport infrastructure amounts to Rs.94 thousand crores, up 20 % over 2008-2009. Within this sector the allocation for shipping has been raised by 97%, that for civil aviation by 63%, and that for roads and bridges by 18%.

In other words the budget includes very significant allocations for inclusiveness programs such as NREG, but it's main focus is on infrastructure development, especially energy and transportation projects aimed at easing growth bottlenecks on the supply side. Seen from the demand side, the total expenditure program of Rs. 10.2 lakh crores will have a massive pump priming effect. Items of infrastructure, rural development, social development and other inclusive components will have high multiplier effects. Hence, the massive expenditure program will continue the strong impetus to restore high growth initiated in 2008-2009.

For financing the expenditure program the budget assumes only Rs 4.7 lakh crores in tax revenues (net of states share of central taxes), given the crisis driven decline in tax buoyancy observed last year. The underlying tax structure has been largely left intact pending the promised introduction of a Direct Tax Code in 45 days and introduction of a unified Goods and Services Tax (GST) on the indirect tax side by 1 April 2010. A few changes introduced in direct tax provisions have been widely welcomed: raising of the tax exemption threshold to Rs.2.4 lakhs, Rs 1.9 lakhs, and Rs. 1.6 lakhs respectively for senior citizens, women, and others; abolition of the Fringe Benefits Tax; abolition of the 10% surcharge on personal income tax; abolition of the Commodity Transactions Tax; etc. However, less popularly, the Minimum Alternative Tax has now been raised to 15% of book profits to maintain revenue neutrality. On the indirect taxes side rates have been adjusted for some items, mainly as rationalization measures to reduce the multiplicity of rates, but in some cases the changes appear to be arbitrary.

The provision for non-tax revenues has been raised by almost 47% over the 2008-2009 provision to Rs.1.4 lakh crores, mainly based on the assumed realization of Rs.35,000 crores from 3G spectrum sales. On the other hand the provision for non-debt capital receipts has been reduced from over Rs 12 thousand crores in 2008-2009 to only a little over Rs.5000 crores this year. In particular, despite the much talked about PSU divestment program, only Rs.1120 crores has been indicated as the proceeds from such divestment at the moment. Further developments are likely on this front later in the year. That leaves a massive fiscal deficit of Rs. 4 lakh crores or 6.8% of GDP to be almost entirely financed through market borrowings.

This is the other main factor that has spooked the stock market and it raises genuine risks. Taken together with a deficit level equivalent to 3.5% of GDP for the states, this translates to a total government borrowing program of well over 10% of GDP. There are fears that a public borrowing program of this order will drive up interests and crowd out private investment. In fact, there is adequate liquidity now in the credit market and the RBI can intervene through open market operations to further enhance liquidity if required to prevent a hardening of interest rates. The greater risk is that a deficit of this magnitude, coming on top of a deficit of over 10% of GDP in 2008-2009, is adding over 20% of GDP to the public debt stock in two years. Servicing this large public debt is likely to crowd out public investment in both infrastructure as well as social overheads like education and health. There is the additional risk that further increases in liquidity could stoke inflation, though this been negligible in recent months. Oil prices have started hardening and now there are signs of a major drought in the foodgrain belt in Northwest India. Such a supply shock in foodgrains could easily trigger high inflation.

Pranab Mukherjee is clearly mindful of these risks, and has signaled the urgency of fiscal consolidation as soon as possible. Indeed the Medium Term Fiscal Policy Statement has set targets for reducing the deficit to 5.5% by 2010-2011, and 4% by 2011-2012. It is a measure of the Governments resolve that it has already started compressing the three major subsidies on food, fertilizer and oil, which have been pegged at 2% of GDP in the current year, down from 4 % of GDP in 2008-2009. The game plan seems to be a strong fiscal stimulus for inclusive growth in the short run, followed by fiscal consolidation over the medium term.

[The author is Emeritus Professor at the National Institute of Public Finance & Policy]