BUDGET ANALYSIS: 2009-2010

The Observer Research Foundation held a discussion on Budget 2009-10, on 7th July 2009 at the ORF Campus New Delhi. Mr. N K Singh, former member, Planning Commission and present Rajya Sabha Member chaired the meeting. The other speakers at the meeting were Mr. Surendra Singh, President, Centre for Politics and Governance, ORF, Dr Arjun Sengupta Member of Rajya Sabha, Dr. M Govind Rao, Director, National Institute of Public Finance and Policy, Dr. Surjit Bhalla, Director, Oxus Investments, Prof. Manoj Pant, Jawahar lal Nehru University, Dr. Shashanka Bhide, Senior Fellow, NCAER and Dr. Gurbachan Singh, Jawahar lal Nehru University, New Delhi. The analysis of the Budget discussion, compiled by ORF Fellow Sridhar Kundu, is as follows:

Mr. Pranab Mukherjee presented the second Budget for the present financial year 2009-10, four months after the Interim Budget was presented in Parliament. Both budgets were prepared amid a sustained global slowdown generally and deceleration in India's growth specifically. The jury is still divided on the content of the budget. While most economic analysts believe that the Finance Minister presented a ingenious and well crafted document that would steer the country through the difficult economic times, some have criticized the Budget for ignoring some crucial aspects of the economic and reform roadmap that India had chartered some two decades ago; mainly the next generation reforms were felt to have been left unstated by some quarters. The present paper looks at the economic vision of the Government by analysing various provisions contained in the Budget.

Very briefly, the budget is a document that states expenditure and income of the Government for the current financial year and which reflects the direction of Government policies and priorities. The Union Budget 2009-10 cited three key drivers and challenges for the Government: firstly, sustaining high growth, secondly, increasing the spread and inclusiveness of the benefits of this growth and thirdly, strengthening the delivery system through better governance and processes. The Economic Survey 2008-09 published by the Department of Economic Affairs was also in line with the Union Budget and, for the first time, stated the key challenges, responses and prospects for the economy in Chapter II.

Against the backdrop of the specific challenges facing the Government, the Budget has prioritized several key areas and developed specific calculus for balancing the expenditure with expected income streams from various sources and sectors with their respective co-efficient. Higher co-efficient determines the higher weightage of the sector in the budget and the reverse is also true. This expenditure and income policy of the Government has invited both applause and criticism from various quarters and is broadly discussed under the following key heads.

A. Trade-off between High Growth and Fiscal Prudence:

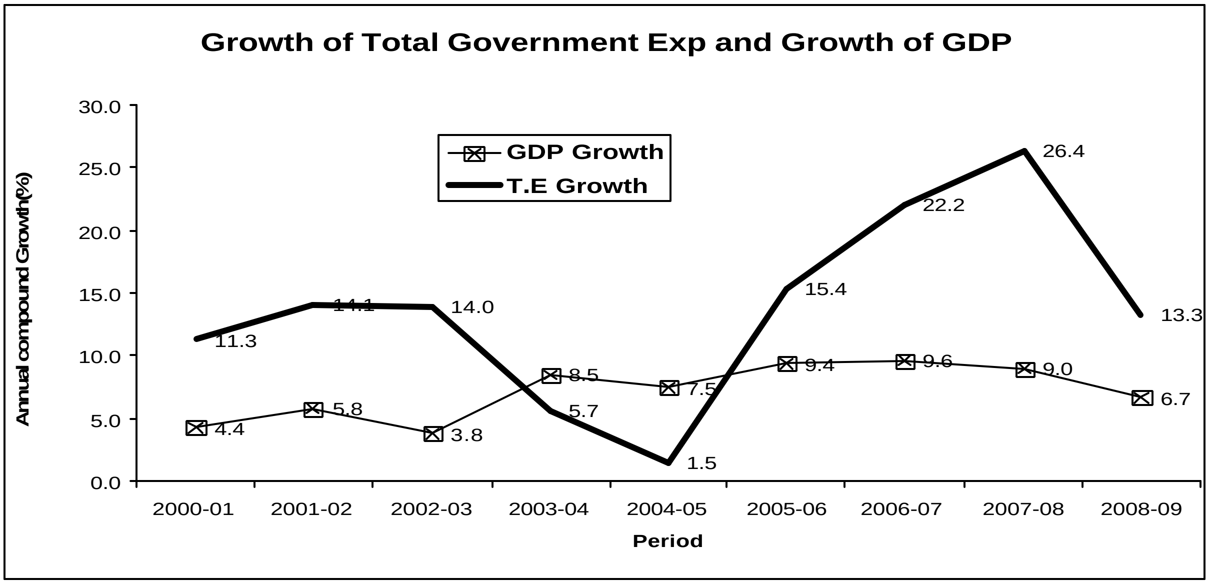
By citing sustained growth as the primary challenge for the Government, the Budget revealed its preference to economic growth over the fiscal efficiency. Most analysts believe that the government has shed fiscal conservatism and has opted for more liberal spending, with its main focus being high GDP growth, even as the economy has recently witnessed slowdown in almost all sectors. As per the Economic survey 2008-09, India's economic growth dipped to 9 percent in 2007-08 from the previous year's growth of 9.7 percent. Global meltdown again enhanced the sluggishness by squeezing the growth rate to 6.7 percent in 2008-09. The manufacturing growth showed a significant decline, to 2.4 percent in 2008-09 from the previous year's growth of 8.2 percent. Growth in agriculture sector also reduced to 1.6 percent in 2008-09 from the previous year's growth of 4.9 percent.[1] Because of the slowdown in growth in these important sectors and the economy as a whole the Budget emphasized on regaining the high growth rates by addressing the demand side problem, with the consequent neglect to fiscal management. The Survey states that the private consumption demand declined from 8.5 percent to 2.9 percent in 2008-09, though it was substantially compensated by the growth of government consumption from 7.4 percent to 20.2 percent, largely driven by the pay commission and NREGA schemes.

[1] http://indiabudget.nic.in/es2008-09/chapt2009/chap12.pdf

In order to boost demand, the Budget has estimated a total expenditure of Rs.10.2 lakh crore for 2009-10. Some analysts believe by estimating high expenditure in the Budget, the finance minister has adopted the Keynesian philosophy of demand driven growth through increase in public spending. This expenditure policy of the Government necessitates discussion on two aspects. The first would involve examining the relative growth of total expenditure of the Government over the last few years. It can be ascertained that there is only an increment of Rs.1.2 lakh crore of total expenditure in the current financial year from the previous year's revised estimate of total expenditure of Rs.9 lakh crore. Figure I clearly identifies that growth in budgeted total expenditure in 2009-10 was just 13 percent which is significantly lower than the growth of total expenditure of 15 percent, 22 percent and 26 percent in 2006-07, 2007-08 and 2008-09, respectively. Therefore, some economic analysts argue that the Union Budget 2009-10 may not be construed as an Expenditure Budget in comparison to the previous year's budget or the ones before that.. However, this discussion needs to be tempered in the backdrop that the current budget has been scripted in the midst of the most severe economic slowdown since the great depression and even the current level of expenditure growth would demand creative revenue mobilization if the government is to maintain any semblance of fiscal prudence. The year 2008-09 witnessed high fiscal deficit of 6.1 percent of GDP. Despite this troubling statistic the Finance Minister has raised the total expenditure, albeit by a small margin, over the previous financial year's revised estimate expenditure.

Increased public expenditure is central to economic growth as per Keynesian economics. Increase spending at the time of high deficit is also supported by the neo-classical unbalanced growth strategy which says that the government spending adds to social overhead capital (SOC) that would facilitate Directly Productive activities through private investment by the 'crowding in' effect. However, India's experience of growth in total expenditure has little correlation to its overall economic growth. A 20-year trend of the growth of total government expenditure in India versus its GDP growth shows no significant relationship between the two and government expenditure has not contributed significantly to GDP growth. However, this calculation cannot reveal the extent of the 'crowding in' of private investment and its impact in facilitating economic growth. What the trend does exhibit is the continuous increase in government spending that reveals the government's unbalanced strategy of growth. It would be important to analyse the quality of government expenditure in order to assess its realization in providing social overhead capital.

Figure I



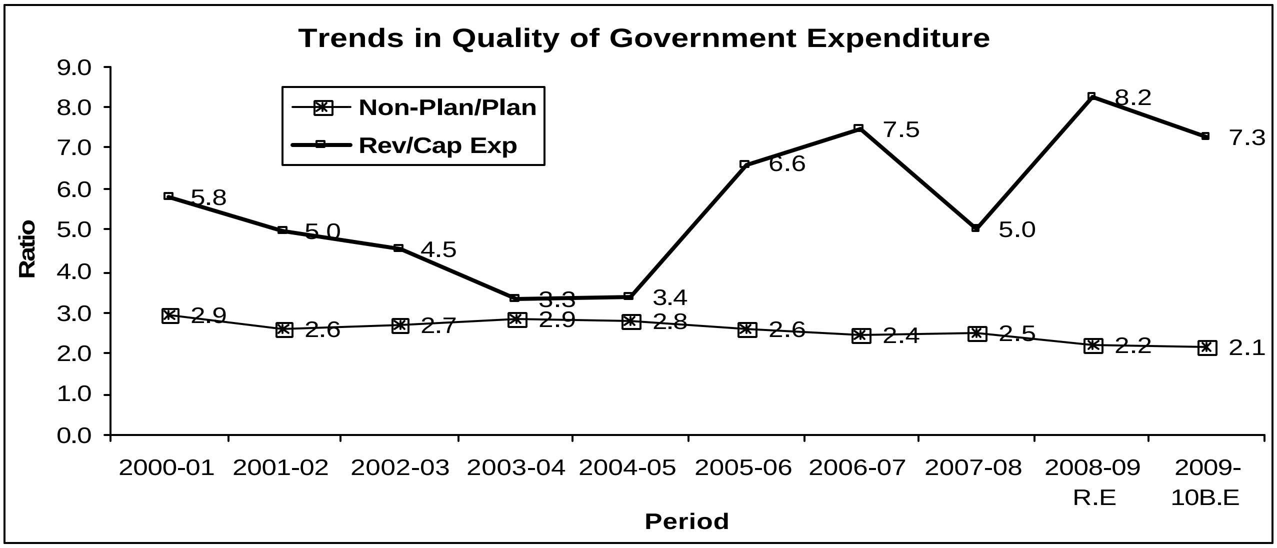
Source: Ministry of finance and economic surveys

This brings us to the second aspect of this discussion: quality of public expenditure. The total government spending, estimated at Rs.10.2 lakh crore during 2009-10, is around 20 percent of country's GDP at current prices. The ratio of revenue and capital expenditure is estimated to 7.2:1 and the ratio of non-plan to plan expenditure is estimated to be 2.1:1. These ratios show a negative correlation with capital formation, as revenue expenditure does not contribute significantly to capital investment and thus has negligible positive impact on employment and income generation. The last five-year trends of the ratio of revenue and capital expenditure show that the ratio of 7.3:1 for the current year budget estimate is less than the ratio in 2008-09 and even 2006-07 (Fig II). The ratio of non-plan and plan expenditure is estimated to be 2.1:1 which is less than 2.9 and 2.8, respectively, in 2003-04 and 2004-05.

The capital expenditure is around 2.1 percent of GDP as compared to 1.8 percent of the GDP in 2008-09 revised estimates. Its growth is estimated to 26.7 percent in 2009-10 in comparison to the previous year's revised estimate growth of (-) 18 percent. In the same way the growth of revenue expenditure has come down to 11.6 percent in 2009-10 Budget Estimate in comparison to 35.16 percent in 2008-09 Revised Budget Estimate. With respect to revenue expenditure, the growth of subsidies in every sector including food, fertilizer and petroleum has been estimated to reduce in 2009-10. In total the food subsidy has been estimated to increase from Rs.52490 crore in 2009-10 from the previous years revised estimate expenditure of Rs.43627 crore, while the total expenditure in fertilizer subsidy has been estimated to come down.

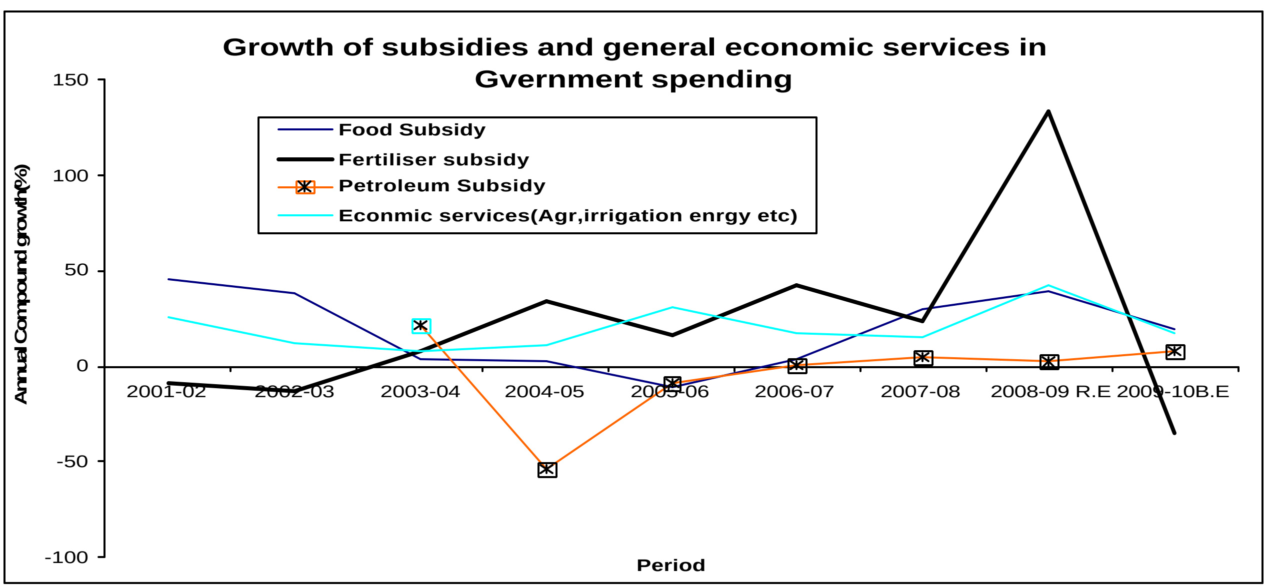
Petroleum subsidy has shown a marginal increase while the growth of plan expenditure in general economic services has maintained the growth momentum despite high expenditure in 2008-09 Revised Budget Estimate. It shows that emphasis on the social sector has been maintained in the Budget. It also exhibits the fine balance between the revenue and capital expenditure and non-plan and capital expenditure maintained by the Finance Minister in the current year Budget.

Fig II



Source: Ministry of Finance

Fig III



Source: Expenditure Budget Vol.I Union Budget 2009-10

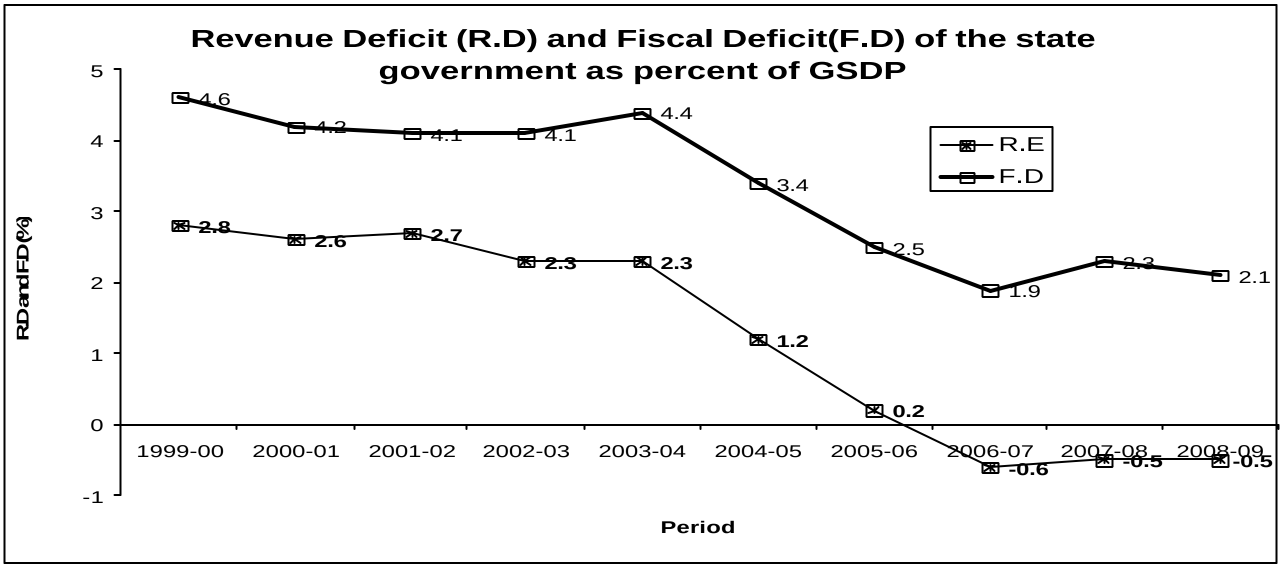
Fiscal Efficiency

The increase in public spending has undoubtedly impacted fiscal efficiency by increasing the pressure on the fiscal deficit by a small margin due to the revenue side constraints expected as a result of slow economic growth. After the Finance Minister gave a budgeted estimate of 6.8 percent of fiscal deficit, there was some discussion about the Government's commitment towards the Fiscal Responsibility Management Act 2003 that articulated efforts to reduce the revenue deficit[2] to zero and to bring down the fiscal deficit[3] to 3 percent by 2007-08. While the Finance Minister was accused of reckless disregard to fiscal prudence by some, such observations are unfair as it must be understood that the Finance Minister is carrying the legacy of the past, the previous financial year's fiscal performance of the Government.

Both, revenue and fiscal deficit, were higher by 191.4 percent and 344.8 percent respectively[4] during April-February 2008-09. Just a small increment over the previous year's estimated expenditure without any growth of receipts resulted in a higher fiscal deficit from 6.1 percent 2008-09 Revised Budget Estimate to 6.8 percent in 2009-10 Budget Estimate. The worrisome factor however is the increasing ratio of revenue and fiscal deficit, which would be detrimental for capital addition. During 2007-08 the revenue deficit was lowest at 41 percent of the total fiscal deficit which rose to 74 percent in 2008-09 revised estimate and the budget 2009-10 estimates it at 71 percent. However the states had performed better in their fiscal front by reducing both revenue below the axis of origin (-0.5 percent 2008-09) and keeping the fiscal deficit just above the origin at 2.1 percent in 2008-09. (Fig II)

Fig: IV

[2] Revenue deficit= Revenue receipts (tax+non-tax)-expenditure on revenue account
[3] Fiscal deficit = total receipts (receipts from tax and non-tax rev and capital receipts including borrowings) – total expenditure (expenditure on both revenue and capital account)
[4] Monthly economic report, Ministry of Finance



Source: State Finances, Reserve bank of India

The total fiscal deficit including states' fiscal deficit of 3.5 of GDP (equivalent to 4 percent of GSDP) results in a significant 10.3 percent of GDP. It will force the government to go for huge borrowings which could result in an upward pressure on the interest rate. Therefore the Keynesian liquidity trap may only be a remote possibility. However the coming years could see some release of pressure on expenditure which is expected to result in fiscal correction. The Economic Survey 2008-09 carries an assurance of restoring the FRBM target of 3 percent of GDP at the earliest. It cites the following factors that could help to realign and help realize the government's obligations under the FRBM: (a) the Pay commission arrears would have been paid out in 2009-10 (60 percent of total) with no further liability in 2010-11; (b) most of the farm loan waiver amounts would be paid out in 2009-10 leaving only marginal amounts for the subsequent year; (c) much of the decline in business and corporate tax collections is cyclical and will tend to be reversed when growth accelerates from the second half of the year; and (d) the expected introduction of the GST in 2010-11 provides an opportunity for setting indirect tax system on the path to producing a sustained increase in revenues, reversing the effect of the fiscal stimulus provided by the government during 2008-09 and 09-10.

B. Spread of Growth and Inclusiveness

Since the majority of India's population lives in the rural areas (71 percent as per Census 2001) and 27.5 percent of total population live below poverty (according to Uniform Recall Method, NSS 2004-05 houshold consumption expenditure survey) inclusive growth continues to remain the most vital challenge for this government.. This challenge demands political acumen and sagacity as well as economic policy maneuvering, both of which are evident in this budget exercise.

To address the challenges of poverty and unemployment the Government has reemphasized its commitment to the National Rural Employment Guarantee Programme which was appreciated by both economists and the masses; this was evident in the popular mandate it received in the recent elections. For this scheme, the Government has proposed an increase in expenditure of 144 percent in 2009-10 over the 2008-09. Critics challenge this by pointing out the actual increase of expenditure is only a modest 0.7 percent over the previous year's Revised Budget Estimate if the inclusion of the expenditure under the Sampoorna Gramin Rozgar Yojna (SGRY) of the previous year into the current year scheme is accounted for. The other aspect that has raised meaningful debate is the actual success of the scheme and its benefits to the poor. Reports and critics suggest that only a meagre proportion of the total expenditure under NREGA reaches the poor. There is difference in the number of work days under NREGA between the data available from the Ministry of Rural Development and National Sample Survey (NSS). Out of the NREGA expenditure, 60 percent is actually spent and out of this only 60 percent reaches the poor, thus resulting in a meagre 36 percent being actually spent on wages for the unemployed. By some accounts, from this 36 percent of the expenditure, only 9 percent reaches the rural poor. The substantive debate therefore is not on the increase in expenditure but in the effectiveness of the disbursals and quality of the expenditure in terms of its end use.

The Budget also lays emphasis on infrastructure development by providing for a 23 percent increase in highway programmes and an increase of 87 percent expenditure for the Jawaharlal Lal Nehru National Urban Mission Programme (JNNURM). What remains starkly absent is the mention of rural roads and other rural infrastructure such as rural electrification and rural supply chain investments. The experience in Accelerated Power Development Restructuring Programme (APDRP) shows that such schemes are not only deviating from the power sector distribution reforms agenda of the government but have so far also failed to help in the growth of rural electrification. Ignoring rural infrastructure including roads and rural supply chain would not only impede growth of the rural economy, which has been the bulwark against the global crisis, but would continue to retard the food sector.

The agricultural credit flow is estimated to be Rs. 3.6 lakh crore in 2009-10. An interest subvention scheme for short term capital loans to farmers of upto Rs. 3 lakh at 7 percent interest and additional subvention of 1 percent interest incentive to farmers for scheduled repayment performance has been introduced. However, the total plan allocation for agriculture is at a low of 2.1 percent of the total plan expenditure; irrigation and flood control account for just 0.09 percent. Low plan allocation could impact capacity creation in agriculture, irrigation and allied sectors.

C. Tax Reforms

There is an urgent need for structural changes in India's taxation architecture. The Union Budget provides a roadmap towards reforming the tax system. The most prominent promise in the Budget is the implementation of GST (Goods and Services Tax) by April 2010 even while recognizing the inability of certain states to meet this deadline. It will reform the indirect tax mechanisms and bring transparency in tax collection across the supply chain by removing Service tax and Central Value Added Tax (CENVAT) collected by the Centre and VAT by the states. By removing the Fringe Benefit Tax (FBT) and Commodity Transaction Tax (CTT) the Union Budget 2009-10 has clearly announced its seriousness to implement GST by April 2010. There are however some misgivings in certain quarters on the success of these tax reforms in the midst of the current economic slowdown.

Deduction of FBT however could also be understood as a stand alone policy measure to help remove the complexities in tax structure. It would help to reduce the indirect cost for the corporates. Removal of the CTT before its implementation is a good step as every transaction tax increases transaction costs and hence creates a new set of economic distortions. There has been a lot of discussion over the removal of Security Transaction Tax (STT) as it affects the small investors as well. Economic analysts believe that its removal would generate lot of volatility in stock prices.

In India there has always been much debate on the transparency in inter-state taxation where lack of symmetry creates problems for tax collection and its distribution among the stakeholders (states and centre). Lack of information management systems in the states and centre are the key malaise of the existing inter-state taxation mechanics and require significant reform initiatives. Even after implementing the GST lack of transparency and absence of integrated information processes would continue to be a key challenge which would require development of national and state level information grids.

Alongside announcing major tax reforms, the Finance Minister has also stressed on the need for equity in the taxation system. According to him, the steady increase in the share of direct taxes in the Centre's tax revenues from 41 percent in 2003-04 to 56 percent in 2008-09 reflected a sharp improvement in the equity of India's tax system. An increase in the minimum alternate tax from 10 percent to 15 percent is a statement of his endeavour to shift from indirect tax to direct tax that brings greater transparency in the taxation system. This however met the disapproval of the stock market.

The Budget has remained silent on the corporate tax rate. According to the RBI's Annual Policy statement - 2009-10, released on April 29, 2009, the private sector was badly hurt by the global economic slowdown. During Q3 of 2008-09 the private sector growth in sales and expenditure, respectively, came down to 9.5 percent and 12.6 percent in comparison to the Q2 growth rate of 31.8 percent and 37.5 percent.[5] A softer corporate tax regime could allow the companies, particularly the small ones, to respond to the slowdown. As corporate tax is an important part of total tax revenue and its share in total GDP is 4.2 percent in the Revised Budget Estimate for 2008-09, the Finance Minister was concerned about its negative 2 percent growth this year. Besides, the unchanged corporate tax rate could affect private corporate investment further.

Conclusion

Union Budget 2009-10 was considerably constrained by the high expenditure and high rate of deficit of the previous financial year. Against this backdrop the Finance Minster must be complemented for balancing the growth objectives through high level of government expenditure even while walking the tightrope of fiscal rectitude. The inherent construct and nature of the Budget itself restricts flexibility and thereby it may have received some criticism for articulating what some call a "Holding Budget'.

The Budget 2009-10 has clearly placed greater emphasis on the demand side and capacity challenges that India is faced with rather than focusing on supply side distortions that can be resolved through capacity creation. However, low plan allocation for agriculture is worrisome, especially as this sector witnessed pedestrian growth of 1.2 percent in 2008-09. The lack of attention to flood and irrigation can prove to be a major detriment and serious policy measures to remove the dependence of agriculture on monsoon rainfall are clearly lacking.

[5] http://rbi.org.in/scripts/NotificationUser.aspx?Id=4936&Mode=0

The Budget also lacked vision on restructuring of the public sector undertakings, nor did it set any targets for the disinvestment programme. However, the Finance Minister's aversion to use disinvestment for bridging the fiscal gap must be applauded. Implementation of Goods and Service Tax in 2010 is another notable reform measure that has been embraced and could have far greater positive impact on business and economy than can be estimated at this time. The Government has provided the road map and the delivery of this promise along with the benefits that would accrue are eagerly awaited.

The Finance Minister has also hinted at major reforms in the direct taxes architecture by announcing the setting up a committee in 45 days. The reforms will try to reduce and rationalise the tax collection cost, taxation compliance cost and the cost to the economy in terms its distortion.