http://www.atimes.com/atimes/South_Asia/KG08Df03.html

Asia Times Online
www.atimes.com

South Asia

Jul 8, 2009

Mukherjee budget bows to politics

By Kunal Kumar Kundu

BANGALORE - The plunge in Indian stock prices that greeted Finance Minister Pranab Mukherjee's budget on Monday says as much about the inability of market participants to recognize reality before it is thrust in their faces as it does about the dismal content of Mukherjee's budget statement.

The benchmark Sensex slumped 5.8%, the most since early January, as if shocked at the scale of the budget deficit proposed by Mukherjee and at the lack of a coherent reform agenda.

Yet only three days earlier, the budget for Indian Railways, whose finances are kept separate from the federal government accounts, showed clearly which way the wind was blowing. Railway Minister Mamata Bannerjee kept fares unchanged, announced new subsidies and earmarked a mere 3% of total revenue to develop the 156-year-old network. As I stated at the time, "Going by this, it is quite likely that the union budget might not be much different and the supporters of reform might be disappointed." [1]

The day after the election result was announced in mid-May, sweeping a Congress-led coalition into power while banishing to opposition the parties of the left, a 17% surge in stock prices epitomized the bullish hopes for the new government, hopes not borne out by reality. The market continued to ignore global realities thereafter. Not surprisingly it tanked on Monday's budget day.

Like the railway budget, the Mukherjee budget was a give-away affair largely devoid of imagination and notably empty of any indication of real moves towards fiscal prudence. As admitted by Mukherjee, it was a pro-poor, pro-rural area budget - and surely nobody's going to begrudge that.

The target for agriculture credit flow for the financial year to next June 30 was set at 3,250 billion rupees (US$66 billion), up from 2,870 billion rupees. Allocation for the National Agricultural Development Plan, or Rashtriya Krishi Vikas Yojna, was increased by 30%, while that for the Accelerated Irrigation Benefit Program was raised 75%. The budget also provided for a 1% interest rate subvention to farmers who repay short-term crop loans on schedule, thereby bringing down the effective rate to 6%; towards this end, 4,110 million rupees was allocated for the year. The deadline for the debt waiver scheme was extended by six months to December 31, 2009.

The budget also provides 20 billion rupees for rural housing and substantially increases outlays in various other programs. Funds to the flagship National Rural Employment Guarantee Scheme will go up as much as 144% and, under a proposed Food Security Act, rice and wheat will be provided to the poor at 3 rupees per kilogram.

Spending on physical infrastructure will also increase, by about 1,000 billion rupees, an amount that can be supported by the government-owned India Infrastructure Finance Co Ltd and banks.

From the reform point of view, the most important positive statement was an assurance that plans for a Goods and Services Tax are on target and it will be introduced by 2010. This will go a long way towards simplifying the highly complicated indirect tax structure.

The good news on the budget ends about there, as reforms took a back seat and politics won out over economics.

Certainly, at this stage in the financial crisis that is hitting India just as it is the rest of the world, the government had to choose growth over fiscal restraint to bring the economy back on track and prevent the growth rate from plummeting. During the last quarter of the just-concluded fiscal year, government final consumption expenditure grew 21.5% year-on-year, just above the full-year increase of 20.25%. As a result, although private demand was anemic, gross domestic product (GDP) growth was higher than initially expected.

However, government expenditure is not a panacea and it is important that the government start to reduce the deficit to prevent inflation creeping up and to avoid higher interest rates that can prevent the nascent recovery from blooming. This budget provides no clarity as to how the government will withdraw from the market.

The biggest disappointment has to be a clear lack of a roadmap with regard to fiscal prudence. The government's fiscal deficit for the current financial year is pegged at a higher-than-expected 6.8%. Add the deficits of the various state governments along with the various below-the-line items such as oil bonds and fertilizer bonds, and the deficit would be tantalizingly close to 13%. Even this estimate seems optimistic, as the budget makes no provision for the proposed Food Security Act and assumes that current global prices of oil and fertilizers will not rise. It optimistically projects a 15% rise in corporate tax receipts, even as income-tax revenue declines 9%.

With the deficit having more downside to it, nerves were further jangled as the budget failed to give any indication as to how the government will go about the fiscal consolidation process (after having increased the fiscal deficit target), unlike earlier when the Fiscal Responsibility and

Budget Management Act was introduced in 2003. While the Finance secretary did mention after the budget that he intended to bring the deficit down to 4% by 2012, there was nothing to inspire confidence that the target could be achieved.

The easiest way to cap the fiscal deficit would be to move aggressively on the disinvestment front - selling of state-held assets - but that was not to be, clearly because of a lack of political consensus among even the so-called strong coalition partners and despite the absence of the obstructionist, not to say destructive, parties of the left following the May election results.

Whatever its perceived mandate, the government obviously does not have enough political consensus to bring the desired reforms to the table. Despite the strong thrust on disinvestment in the Economic Survey released last week, the government is not going to do the needful, fearful of the political consequences. Banks and insurance companies have been kept out of the disinvestment proposals and the amount of funds to be derived from selling off state holdings will be small as sales focus on undertakings of lesser importance and value.

The budget proposals have the appearance of back-seat driving by the left. I certainly cannot recall another budget that was not criticized by the left despite it being in opposition. The Congress party's coalition partners have made enough noise to ensure that the government has no stomach for reforms. The market's failure to read those signals earlier resulted in the post-budget disappointment and stock plunge.

Nor was there mention of even the intent of bureaucratic or spending reforms that could have helped the government curb a host of wasteful expenditure and plug the enormous amount of leakage in delivering funds - a maximum of only 10% to 15% of resources spent by the government on various developmental projects goes to the intended beneficiaries, as has been well documented.

The government's revenue deficit now accounts for close to 71% of the budget deficit. While a part of the revenue expenditure does add to growth, a greater part goes on housekeeping expenses. Given that the government needs to borrow to bridge the deficit gap, we have a situation where only about 30% of the borrowing will be used for productive purposes, yet this is expected to earn a return that meets the financing cost of the entire borrowed amount. That's a pipe dream.

With inadequate disinvestment proceeds and a government unable to temper its profligate ways, investment in infrastructure, among other sectors, continues to be inadequate.

Hence, while the Economic Survey stressed the need to spend about 9% of GDP on infrastructure during the 11th five-year plan (2007-2012), the envisaged investment in infrastructure during the current financial year is still less than 5% of expected GDP. As a result, India's inability to set is fiscal situation to rights will continue to result in perennial under-investment in areas that could spur economic growth.

Budget documents show that the government's gross market borrowing in the current fiscal year will be about 4.51 trillion rupees, a 23% increase on the borrowing target cited in an interim budget in February. The government must somehow manage its humungous borrowing needs without triggering inflation and while retaining a soft interest rate regime that can spur domestic demand and investment.

The government has missed a golden opportunity to stamp its authority and to show a real concern for reform. It should have given direction to ensure structural improvement in the economy, creating a sound foundation that could have led to higher growth. Instead, it preferred to choose an easier path.

Note

1. See http://kunalsthoughts.weebly.com

Kunal Kumar Kundu, a former senior economist with a leading bilateral chamber of commerce in India, now works with the Knowledge Service Division of Infosys BPO Ltd. He has a Masters in Economics with specialization in econometrics from the University of Calcutta. The author here is expressing his personal views.