South Asia
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India's interim budget a case of force-fitting

By Kunal Kumar Kundu

As India heads into the next general election, the government, at the fag end of its rule, presented its interim budget on Monday with the hope of making a statement that things were not as bad as perceived.

The interim budget also showcased the government's expectations for the financial year ending March 2015 (FY15). However, not much importance should be placed on the statement for next year since it is the prerogative of the new government that is likely to be formed by early June to present the budget for the full year. Nevertheless, the present government's expectations illustrated its sense of optimism, which is not backed by reality.

More of that later. First, to what the budget says for the current financial year, which ends next month. The highlight is the bold statement that India's fiscal deficit will be reined in at 4.6% of gross domestic product (GDP), while the government was committed to sticking to its earlier target of 4.8%. What explains this over-achievement? Essentially, it boils down to:

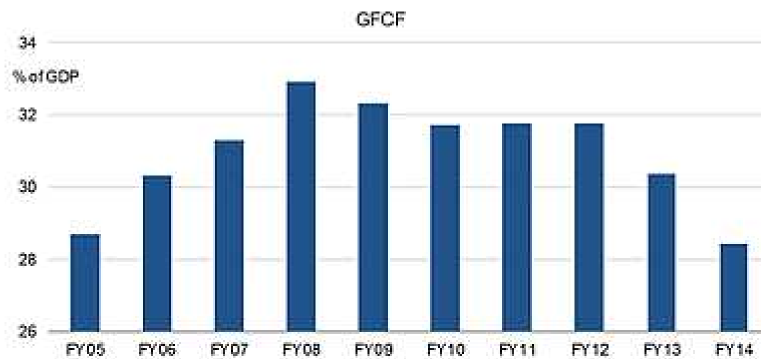
A large dollop of financial repression: As tax revenue falters owing to a slowing economy, desperation for revenue led to state-owned enterprises being forced into paying much higher dividend than warranted. A good example is the coercing of India's coal monopoly Coal India Ltd into paying a stratospheric dividend that will yield the government upward of 160 billion rupees (US$2.6 billion) as dividend and another 30 billion rupees plus as dividend distribution tax in one go, while the company itself desperately needs to make investments to arrest its falling productivity. Not only that, oil companies are also being forced to pay a higher share of oil subsidy than they did earlier.

Creative accounting: The transfer part of the current year's expenditure to next year's budget to show reduced levels of expenditure indicates creative accounting at work.

Over expectation of revenue generation: The government continues to show revenue generation from a component "other telecom services" to the tune of 408.47 billion rupees, though even the government is aware that it will be lucky to get even half that amount. The major revenue that it hopes to earn is through the auction of 2G spectrum. Although the 2G spectrum auction was highly successful and it will yield a total revenue of 611.62 billion rupees, the government will only get around 180 billion during FY14. On the other hand, the one-time bandwidth fee of 100 billion rupees that the government was hoping to get will not materialize this year as the move to levy this has already been challenged in the courts and the issue is unlikely to be resolved any time soon.

Forced cuts in necessary expenditure while wasteful expenditures are hardly touched: In its desperation to stick to the fiscal deficit target in a scenario of falling revenue, belt-tightening measures (read expenditure curtailment) were totally misdirected. The government continued to choose the easy way out - that of severely curtailing capital expenditure (read public investment) while revenue expenditure (a large chunk of which is wasteful in nature, mainly in the form of ill-directed and misconceived subsidy) has hardly been touched. As per the budget document, while revenue expenditure was lower by a mere 2.6% as compared with what was budgeted, capital expenditure was cut down by a remarkable 16.7% to stick to the stated fiscal deficit target of 4.8% of GDP. Not surprisingly, India's gross fixed capital formation (GFCF) for FY14 is likely to be around 28.5%, the lowest in a decade.

Plummeting investment

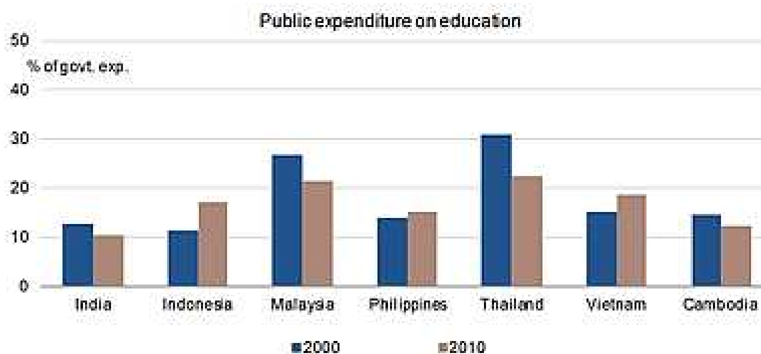


Source: Reserve Bank of India

Given that inadequate physical infrastructure poses the biggest challenge to India's growth momentum while at the same time pushing up inflation, one wonder's at where government priorities lie.

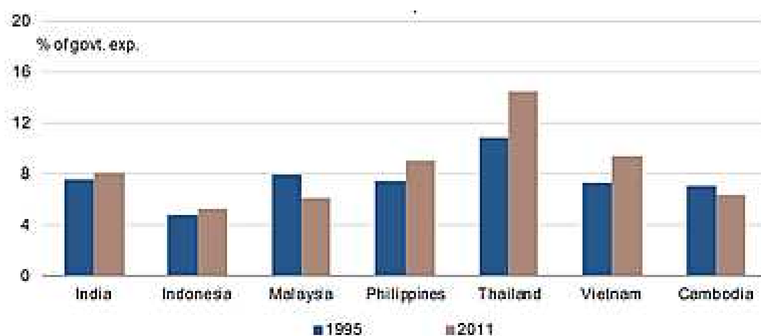
The problem even extends to soft infrastructure - human capital, if you will. With a large chunk of revenue spent on subsidies and interest, India's share of public expenditure on health and education is among the world's lowest, especially if one considers the economies of the 10-member Association of Southeast Asian Nations, which have a positive demographic trend.

Compromising on education...



Source: World Bank World Development Indicators

... as also on health



Source: World Bank WD

While India desperately needs to flip its growth model from being consumption led to investment led, one would have expected more commitment from the government to buoy the growth drivers. Clearly, whatever angle one looks at, India's future growth prospects are being compromised at the altar of populism.

Coming back to expectations for FY15, the government has factored in nominal GDP (expenditure side) growth of 13.4% in their revenue and expenditure calculation. The fact is, during FY14 the government expected a nominal GDP growth of similar magnitude. However, the revised estimate indicates a lower than expected GDP growth rate, that too with the GDP deflator (read implicit inflation) showing a rise of 6.97% for the year.

During FY15, the government expects the real GDP growth to be around 6%. For the time being, let us leave aside the fact that the 6% growth rate is way too optimistic and assume that what the government expects is correct. This would mean that inflation will have be 7.4% to reach the nominal growth target of 13.4%.

The problem is the government actually expects inflation to be higher next year as compared to the current year, even as inflation is finally showing some tendency to ease. Clearly, despite its stated abhorrence of inflation, the government is actually banking on higher inflation to achieve its GDP growth target.

Besides this, the government expects tax revenue to go up by nearly 18%, while for FY14 the growth rate in tax revenue collection is likely to be less than 13%.

Through such over-optimistic assumptions, the government believes that the fiscal deficit for next year will be 4.1% of GDP. Achievement of this target will definitely require enhanced creativity in accounting practice and more draconian financial repression.

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