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Opinion: More hype than reality

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The union budget presented by Pranab Mukherjee, India's Finance Minister, on Friday turned out to be more of a feel good budget without any real intent to attack the malaise afflicting the economy. It's a budget that looks good on the surface, but scratch deeper and the positive vibes will evaporate.

First, the positives.

The proposal to ease Foreign Direct Investment norms (although there were neither any concrete sector specific announcements, nor any timelines) is a welcome statement. The thrust on infrastructure, although expected, is definitely a big positive for an infrastructure deficit country like India. The budget will provide Rs1,735bn for infrastructure development, which is around 46 per cent of the total plan allocation for FY11. Further, allocation for road transport has been increased by over 13 per cent. There is an increased thrust on speeding up the expansion of new generation capacities. Plan allocation for power sector has been doubled to Rs51bn in FY11. Not that the infrastructure woes would be fully ameliorated, but at least the gap will be reduced. There has also been a clear announcement of a deadline for ensuring reforms of both the direct and indirect tax structures i.e. implementation of the Direct Tax code (DTC) and Goods & Services Tax (GST) by 1st April, 2001. Readers, though, would do well to remember that the deadline for the implementation of the GST has remained quite dynamic, the proposed implementation dates have been changing frequently over the years. Apart from that, there were some usual sound bites about focusing on the poor through investments in the social sector. The feel good factor, though, was the explicit talk about fiscal prudence as the budget talked about some specific numbers in terms of fiscal deficit, aiming to reduce it to 4.1 per cent by the year 2012-13 from the proposed 5.5 per cent for 2010-11. The market lapped it up and the Bombay Stock Exchange benchmark Sensex boomed. Therein, the good news ended.

Second, the negatives.

The statement about fiscal prudence, a highlight of this budget actually gives a sense of déjà vu. It is important to note that the Fiscal Responsibility and Budget Management (FRBM) Act was notified in July 2004, imposing strict fiscal and revenue deficit targets for the government, only to be held under suspended animation when things spiralled out of control a year down the line. It, therefore, remains to be seen whether the promise this time round can be kept. There have been umpteen examples of India frittering away its resources through unabashed wasteful expenditures. Revenue conservation has never been a hallmark of Indian policymakers (nay politicians). Even when the Gross Domestic Product was growing at around 9 per cent plus, increasing expenditure more than matched increasing revenue. The scenario this year is nothing new. Of the projected fiscal deficit of Rs3,814bn, the revenue deficit accounts for Rs2,765bn, which means that, nearly 72.5 per cent of the fiscal deficit is accounted for by revenue deficit. This means that, only a fourth of the government's borrowing would be used for capital investment while the remaining three fourths will be utilized for the government's housekeeping expenses. Not surprisingly, the debt service burden will continue to be a worry. And why not surprisingly? The budgeted gross interest payment at Rs2,487bn for the coming financial year, accounts for more than 65 per cent of India's fiscal deficit. This means that the government needs to borrow a lot of money simply to meet its interest obligations.

The inability of the government to reduce its wasteful expenditure, given the rampant corruption, has resulted in its increased dependence on disinvestments (targeted at Rs250bn during 2010-11) to meet its expenditure needs. Not that disinvestment is a bad policy. Indeed the government has no business to be in business. But this clearly reflects on the inability of the government to manage its finances appropriately. There is a limit to which the government can keep on selling its assets to finance its expenditure. And this budget, like all the previous budgets shows no intent to talk about provisions to reform the bureaucracy and tackle corruption.

Going through the deficit numbers, it does seem that the finance minister might have got his number correct. The goal to reduce fiscal deficit from 6.7 per cent to 5.5 per cent next year depends crucially on the government's ability to increase the gross tax revenue by 18 per cent (as has been projected). This is based on the assumption that the nominal GDP will grow at around 12.5 per cent. This is definitely an achievable target. While food inflation is likely to be tamed due to sheer base effect, core inflation will rise again because of the base effect. One should remember, that India's official inflation index was negative around the 4th quarter of last year.

Partial roll back of stimulus through hikes in excise duty, imposition of duty on petroleum and cement, among others, will have a cascading effect on inflation. Hence the overall inflation for the next financial year is likely to be between 5 to 5.5 per cent, which implies a real GDP growth of between 7 to 7.5 per cent, if India is to record a 12.5 per cent nominal GDP growth. This does seem an achievable target. Where things can go wrong, however, is the target of Rs250bn for disinvestment. Given the global economic situation, which is unlikely to improve much going forward, this target might not be achieved. And this is a crucial component of the overall deficit reduction mathematics. It seems that the government is expecting the inflation to remain at elevated levels, which would result in high nominal GDP growth, so that they are able to meet their revenue target. The problem with this is that, high inflation can impact the domestic demand going forward. The recent revival of domestic demand is essentially a reflection of preponement of future demand attributable to the positive effects of government spending and lower core inflation. As the effect of government spending wears off and core inflation starts to rise, demand is unlikely to pick up enough to match the ambitious growth target of the government.

This budget also failed to address the needs of the agricultural sector adequately. Despite, the impact that the failed monsoon had on the Indian agriculture during the current year, the budget does not talk about any agricultural reform or any major thrust for the sector, other than a few announcements. Debt waiver schemes or extension of repayment periods are only aimed at amelioration of short-term problems but these do not lead to any capability building that this sector desperately lacks.

Overall, the budget lacks in imagination and India has lost another chance of taking that all important next step that could potentially have unleashed the true power of the economy.

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