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Reading between the Lines of Indian Budget

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Indian media, including the television news channels and the English-language press, have analysed and dissected the Indian Budget 2013-2014 down to its last ligament, and, at the end of it, decided that it was not as good as it should have been nor as bad as it could have been. Relevant data will help dispel such ambiguity.

First, the budget provides for a substantial increase in capital expenditure. The Plan expenditure, which represents capital spending, is targeted to rise from Rs 4.29 trillion in the revised estimates to Rs 5.55 trillion next year (2013-2014). This is a substantial increase which is based on a number of announcements in Finance Minister P Chidambaram's budget speech – especially with an emphasis on infrastructure projects.

It has been announced that funds are being earmarked for the Delhi Mumbai Industrial Corridor (DMIC), a project that has been waiting to take off for the last few years. There is also a promise of the Chennai-Bengaluru (Bangalore) corridor with Japanese assistance, as well as investments in roads, ports and the Northeast corridor to link Manipur with Myanmar, with multilateral assistance. Moreover, 3000 km of roads are to be awarded for construction under the National Highways Authority, and there is considerable emphasis on urban investment in infrastructure, waste- and water-management. These are important and welcome areas of emphasis that badly need attention and investments. The announcements also signal that the Cabinet Committee on Investment will take its responsibilities seriously and monitor project approvals and implementation more effectively.

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There are promises of funds for the Railways for modernisation. The Railways Minister was unable to do much in the Railways Budget except to revise freight rates by 5.8 per cent and promise better safety and more trains. Investments will have to come from capital provided in the (Indian) Union Budget, and this has been promised.

There is recognition of the need to match availability of skills with those needed in the employment market. Welcome too is the focus on creating institutions and opportunities for skill development and linkages with manufacturing and service industry through public-private partnerships. The National Skill Development Corporation is already taking initiatives, and the budget announcement reflects the importance of this activity.

Laced with Scepticism

The enthusiasm at these announcements gets tempered by scepticism when one looks at the real numbers. Even though there is a substantial increase in the Plan allocation, the increase on capital account is quite modest, from Rs 8.5 trillion in the revised estimate for the current year to Rs 11.2 trillion in the budget estimates for next year. Considerable amounts of the increase in Plan allocation appear to cater for revenue expenditure, leaving one to wonder whether these infrastructure announcements would receive adequate funding for implementation.

A source of worry is the comparison between the budget estimates of last year with those of this year. The increase between the two is far more modest, at 10 per cent, signifying that there has been a lot of contraction of expenditure in recent months and that, perhaps, all that is being done in this budget is to provide these funds next year. In short, there is a roll-over of expenditure from this year to the next, which appears to account for the apparent sharp increase in the latest budget allocations. If this argument were correct, then funds will actually flow to those projects which have been starved of funds this year rather than to the new projects that have been so enthusiastically announced.

The second critical aspect arises from the projections of revenue. Revenue receipts are projected to increase from Rs 8.7 trillion in the revised estimate for the current year to Rs10.5 trillion next year. This is an increase of approximately 19 per cent. Taking the past trends, this appears to be a very steep increase. The argument appears to be: this is making up for the last year – the budget projections then were for Rs 9.3 trillion, and the shortfall has been a steep Rs 1.3 trillion between the estimates and actual figures.

There are promises in the budget about better tax compliance, a surcharge on tax for those earning more than Rs 10 million a year, as well as some hikes on expensive cars, SUVs, high-end mobile phones and yachts. It remains to be seen whether these measures would lead to the kind of revenue receipts that are expected in the budget. The expectations of non-tax revenue receipts, which include disinvestment receipts, revenues from sale of telecommunication spectrum and other receipts, are expected to be 40 per cent higher than those in the current year – an argument that appears to defy logic.

Credit Rating Concerns

While the measures to tax the rich and spare the middle-income groups are welcome, scepticism arises from the concern that, perhaps, these numbers have been tweaked to address quite a different concern. India has been on the brink of its credit rating being downgraded by the international credit rating agencies – any further deterioration would drive the bond ratings to junk bond status. The concern of the rating agencies has been about the fiscal deficit in India.

In announcing that the current year's deficit will be 5.2 per cent of the Gross Domestic Product (GDP) and projecting next year's deficit at 4.8 per cent, the Finance Minister has done a commendable job of signalling his intention to pursue the path of fiscal prudence. The credit rating agencies would be heartened by these signals, but the worry is whether these signals can be considered reliable indicators of the direction that public finances would take.

There are other worries as well. Inflation is very high, and there is little in the budget that signals measures to control inflationary pressures. The Finance Minister admits that these are due to supply-side constraints, especially in the manufacturing sector caused by poor capacity utilisation in industry and reluctance to invest in new manufacturing. The investment allowance announced for fresh investment of Rs 1 billion in capital equipment is an attempt to enthuse industry into investing in fresh manufacturing capacity. However, there are few other measures in the budget to reduce supply-side constraints. On the other hand, the allocation of Rs 100 billion for the Food Security measures signals expenditure that is not matched by improved production or supply; and it is thus an inflationary drag.

Another concern is about the current account deficit. The Finance Minister clearly admits that a current account deficit of five per cent of GDP is unsustainable and that energy and gold imports occupy a significant proportion of the total import bill. He argues that he would need US$ 75 billion next year to bridge the current account gap, but there is little in the budget to identify measures to reduce energy imports or to encourage exports.

RBI's Advocacy

The Reserve Bank of India (RBI) has been pointing out, for long, that measures on the policy front are required to encourage exports and improve energy production within the country, but this budget has little in these areas.

The Finance Minister must be given credit for avoiding populist measures and adhering to a path of fiscal reform. It is also clear that he is politically constrained, due to coalition compulsions as well as electoral concerns, from doing all that he might have liked to do. It is also clear that the fiscal space created in the last three years can be contracted only over time, and that any steep contraction would affect growth even more. He appears to have done the best he can, but perhaps, not even to his entire satisfaction.

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