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The Indian Budget 2008-09: An Assessment

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The budget proposals presented by the Indian Finance Minister in Parliament on 29 February have provided a number of concessions for the middle class and the farmers. It was a well thought out document and there has been an attempt to control inflation and, at the same time, stimulate growth.

The Indian economy has been growing at over 8.7 percent for the last 12 consecutive quarters. Per capita incomes have risen over 50 percent at current prices in the last six years, and are over US$1,000 now. Savings, both public and private, have grown, and are close to 31 percent of gross domestic product (GDP) now, and capital formation is at even a faster pace. Asset markets, represented by both financial and real assets, have been buoyant and this has resulted in a transfer of real wealth to even small landholders.

At the same time, there are real pressures. The increases in prices of oil and other commodities need to be adjusted into consumer prices. The Indian government has been cushioning the consumer from petroleum product increases through a mechanism that allows oil-marketing companies to float bonds in the market to offset cost increases. The government guarantees these bonds. There are also unpaid subsidies to the fertilizer industry, for which the government has issued bonds in favour of these companies. Finally, the large capital inflows force the Reserve Bank of India to purchase dollars to keep the rupee from appreciating too rapidly, and the excess liquidity is mopped up through market stabilisation bonds, the interest for which is borne by the government. All these are measures that prevent true costs of goods and services from being passed on to the consumer, and the costs of distorting prices and markets become a burden on the budget. With oil exceeding US$100 a barrel, these distortions and costs are likely to increase.

There is also a concern over food prices. With an economy growing at around nine percent and per capita incomes rising, whatever the food-GDP elasticity, consumption of food grains is bound to increase. Growth of agriculture is projected to be 2.6 percent in the current year, and has been around three percent in the last three years. Given the supply constraints, prices of wheat and rice are on the increase, as also those of edible oil and pulses. Prime Minister Manmohan Singh has said that an era of rising food prices is inevitable and is a corollary of

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growth and larger numbers of people getting out of poverty. During the current year, this is exacerbated by global increases in food prices. Wheat output is expected to be lower than last year and there are pressures on a number of crops, including coffee. Food price inflation is, therefore, a reality that the Indian government has to contend with.

There are worries of a slowdown in the global economy, led by financial crisis in the United States markets. This slowdown would affect exports and investments into India as well as valuations in the financial markets. Though the economy is less dependent on global trade than the Chinese economy, the effects of a slowdown in global growth would be felt in India. There are estimates that this could reduce growth by up to one percent.

Finally, this is the last budget of the current United Progressive Alliance (UPA) coalition government. The new Parliament (Lok Sabha) has to be constituted before May 2009 and elections need to be held, latest, by March next year. Therefore, this budget has, of necessity, to cater to the aspirations of the people and to give a signal to the voters that the concessions are voter and people friendly, and appeal to as wide a section of the Indian populace as possible.

In dealing with these complexities, the budget is a carefully crafted document that takes a middle path of encouraging growth without adding inflationary pressures.

The primary focus is on agriculture. Rural India accounts for over 50 percent of the population and most farmers are in subsistence agriculture. Crop yields are low by international standards and there has not been adequate capital formation in agriculture to encourage the use of higher technologies or mechanisation. Substantial areas are rainfall dependant and vagaries of the monsoon often decimate yields, leading to continuing indebtedness among poor farmers. There have been widespread incidents of farmer suicides in many regions –there is an estimate that, in the last four years alone, over 60,000 farmers have committed suicide due to an inability to repay their short-term crop loans. The government has announced a waiver of agricultural loans in the budget of over Rs.60,000 crore (US$15 billion). This would benefit all small and marginal farmers with land holdings of three hectares or less. As banks and co-operatives disburse the loans, the government has promised to reimburse the liabilities to the lenders over a period of three years. The farmers would become eligible for fresh loans. Earlier this month, the government had announced a US$6 billion dollars plan for agriculture and food security that includes a package of seeds, fertilizer, irrigation and technology to help agriculture grow faster. In this budget, there is emphasis on new irrigation programmes as well as measures of storing surface water and sustainable exploitation of ground water.

The next area of focus of the budget is education. The mid-day meals programmes (school meals) is to be extended to all schools. Six thousand high quality middle schools will be opened to provide skills and knowledge to primary school leavers. Three new Indian Institutes of Technology and three new Indian Institutes of Management are to be opened. Sixteen central universities are to be set up. Most importantly, there is recognition that there is a mismatch between skills needed in the economy and the skills available, leading to structural unemployment and a pressure on wages of skilled personnel and managers. A major programme for improving skills has been formulated with public private partnership.

On health, outlays have been increased 15 percent, with a focus on enlarging rural health programmes. A tax holiday for entrepreneurs wishing to set up hospitals in Tier Two and Tier

Three cities has been announced. There are concessions on the imports of vaccines and life saving drugs.

Turning to the large middle class, the budget announcements include a large number of concessions. The Income Tax exemption limit has been raised from Rs.100,000 to Rs.150,000 and would result in a cascading benefit for all tax payers. Concessions for women and the elderly have been enhanced. Excise duties on small cars, two wheelers and some consumer items have been reduced.

Corporate taxes have been left undisturbed. Reduction in corporate taxes helps the company, the promoters and the shareholders but a reduction in input taxes helps the manufacturing industry as a whole. This budget has reduced excise duties on manufacturing from 16 percent to 14 percent, a reduction that would make manufacturing more competitive. It would also pave the wave for the integration of a national Goods and Services Tax in 2010. The Central Sales tax, levied on inter state sales of goods, has been reduced to two percent. The moderation in excise duties has been due for some time and the Finance Minister, Mr P. Chidambaram, has taken advantage of the buoyancy in revenues to reduce duties. On customs duties, peak rates are unchanged, given that there has been a significant appreciation of the rupee that has made imports cheaper. Some selective concessions that are industry-specific have been granted.

In the financial sector, a levy on transactions in the commodity exchanges has been announced. Similarly, there is an increase in short term capital gains tax from 10 percent to 15 percent.

There are also a number of programmes that are aimed at the Scheduled Castes and Tribes, the minorities and the Muslims. This is the first time that the budget speech carries details of such affirmative action programmes. It appears to be a measure to win the votes of these sections in the elections though it is not entirely clear whether these sections would be swayed by these give-aways. At least, on paper, the government appears to have managed to balanced populism with fiscal responsibility, though reality it is much less forgiving (see Table 1).

Table 1: Tax Revenues

Tax revenues

Rs bn, fiscal years beginning April 1

		2007/08		2008/09	% oya	
	2006-07	**Budget**	**Revised**	**Budget**	**2007/08**	**2008/09**
Gross tax revenues	4735.1	5481.2	5854.1	6877.2	23.6	17.5
Union excise duties	1176.1	1302.2	1279.5	1378.7	8.8	7.8
Customs	863.3	987.7	1007.7	1189.3	16.7	18.0
Corporation tax	1443.2	1684.0	1861.3	2263.6	29.0	21.6
Income tax	750.9	987.7	1183.2	1383.1	57.6	16.9
Service tax	376.0	502.0	506.0	644.6	34.6	27.4

However, the expenditure appears to be understated for three reasons:

1) Expenditure to the tune of 2-2.5 percent of GDP (on oil bonds and fertilizer subsidies) remains off budget;

2) There is no provision for the potential hit to fiscal finances from the Sixth Pay Commission's recommendations that are expected in April this year; and

3) Thee loan waiver of Rs.600 billion (1.1 percent of the official full year GDP for 2008-09) is not reflected in government spending.

The Finance Minister has preferred to show rosy projections rather than be realistic and be fiscally responsible by including in the budget at least some estimate of the potential hit from the Pay Commission and the loan waiver.

The fiscal deficit for 2008-09 is forecast at 2.5 percent of GDP, lower than the better-than-expected deficit outcome of 3.1 percent of GDP for 2007-08, and lower than the three percent of GDP mandated by the Fiscal Responsibility and Budget Management Act. It is highly unlikely that the government will achieve its forecast for next year's fiscal deficit owing to aforementioned factors that will cause actual spending to be higher than the budget forecast. The officially stated improvement in fiscal deficit appears to be an exercise in virtual reality.

Net borrowings for 2008-09 have been budgeted at Rs.1 trillion, lower than expectations of Rs.1.1 trillion. The gross borrowing estimate is also lower-than-expected at Rs.1.45 trillion. Critically, it does not include oil bond redemptions of Rs.130 billion. It remains to be seen how the government finances maturing oil bonds. Moreover, the budget estimates do not provide for any outgo from anticipated salary increases owing to the recommendations of the Sixth Pay Commission. The debt waiver granted to farmers has also not been included in the government's expenditure and this lends upside risks to the fiscal deficit estimate. In short, it is unlikely that the Finance Minister's expectations on revenues would be met, leaving the next government with the unhappy task of cleaning up the deficits.

The debt waiver scheme is not without its perils. Periodic debt waivers set up incentives for farmers to be irresponsible in borrowing, knowing that they will get a waiver at a future date. They contaminate the opportunity to build a genuine financial ecosystem surrounding farmers, which can cope with the risks and requirements of these users. If the intent is to help 'poor people', then landholders are the wrong target audience; poor people are those who do not have land. While 80 percent of holdings are covered in the debt waiver plan, the government has gone on to offer a 25 percent write -ff even to the top 20 percent of holdings. The UPA's agenda was to focus on a number of flagship welfare programmes. The spending is underway but it hasn't been delivering results. The 'flagship programmes of the UPA' are not working too well and the UPA isn't winning elections. This debt waiver programme appears to be an effort at trying to somehow get state money to some voters.

The Economic Survey, tabled in Parliament a few days back, had indicated that, if growth were to pick up, the acceleration of reforms was necessary. Several areas, including reforms in banking, insurance, labour markets and privatisation initiatives, have been mentioned in the document. There is also an urgency expressed about the need to hasten the implementation of infrastructure projects. It is interesting that the budget speech makes no mention of any reform or even of infrastructure constraints and the need to address them. It is surprising that there is no effort to deal with the existing obstacles to growth.

Finally, several important initiatives have not been fleshed out. There is an urgent need to upgrade skills for ensuring employability but the details of this scheme have not been worked out. Irrigation is important but funding has not been provided. There is mention of corporate bond and currency derivative markets but the road map is not clear. The announcements outweigh the actionable programmes and it does appear as though a number of promises are only keeping the voter in mind and are not clearly thought out government policy.

It is clear that there will be elections before the end of the year.

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