CONTINUITY & CHANGE

ANALYSIS

Pragmatic Approach to Fiscal Consolidation

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The Union Budget of the new government may seem to be a continuity of the previous government but has much to offer when analytically examined. If implemented, it will usher in a change in the very fabric of Indian policy making and business thinking in a very short time because it proposes widespread changes in different segments of the economy

THE UNION Budget of July 2014 was prepared in the backdrop of a difficult economic situation. Globally, economy recovery has not been consistently robust and financial markets are not stable. ECB has recently announced negative interest rates while the US has yet not finalized its tapering plan. The scenario in the emerging countries is dismal with growth in BRICS not following a steady trend. India was one of the countries to have been relatively shielded in the initial years from the global financial crisis, but the growth rate of the economy dropped to sub-5 per cent levels in 2012-13 and 2013-14. The downward trend in growth was recorded in all sectors of the economy- agriculture, industry and services. Along with dismal growth, inflation has persistently been high. Though, the average inflation rate measured by Wholesale Price Index (WPI) dropped to 6 per cent in 2013-14, it was still above comfort levels. Also high food inflation has been a cause of concern for quite some time now. While enforcement of policy measures lead to curbing of the gold imports, depreciation of the Indian rupee aided India in boosting its exports in 2013-14. Consequently, current account deficit (CAD) recovered from 4.7 per cent of GDP during 2012-13 to 1.7 per cent in 2013-14 (Figure 1).

Fiscal Indicators

The fundamental objective of the policy stance of the new NDA government, also reflected in the Union Budget 2014-15, is minimum government and maximum governance. In view of the above backdrop, the effort made in the Union Budget of July 2014 in containing deficits and not resorting to higher debt is indeed laudable (Table 1). The budget aims for a sustained growth of 7 to 8 per cent during the following 3-4 years, alongside a manageable current account deficit, a reduced fiscal deficit and lower levels of inflation. The plan laid out for fiscal consolidation is to bring down the fiscal deficit to 3.6 per cent in 2015-16 and further to 3 per cent in 2016-17.

The general slowdown in the economy impacted the revenues from taxes during 2013-14 but with recovery underway, some positive growth is expected in the current year (Table 2). On expenditure, while outlay on defence is constant and interest payments as a percentage of GDP budgeted to decline, that on subsidies would increase mainly on account of food subsidy (Table 3).

Select Policy Announcements

The Union Budget lays emphasis on agriculture, creation of a strong thrust for infrastructure advancement, generation of employment by different

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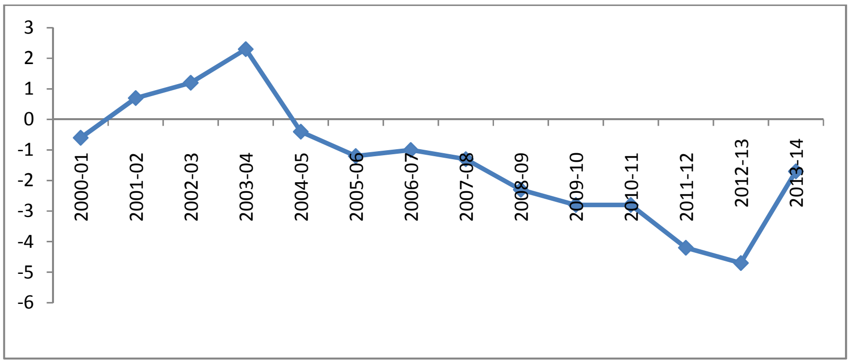
Figure 1: Current Account Deficit (Percentage of GDP)



Source: RBI.

Table 1: Deficits as percentage of GDP

Year	RD	GFD	PD
1980-81	1.4	5.7	3.9
1990-91	3.3	7.8	4.1
2000-01	4.1	5.7	0.9
2010-11	3.3	4.9	1.8
2012-13	3.6	4.9	1.8
2013-14 (RE)	3.3	4.6	1.3
2014-15 (BE)	3.0	4.1	0.8

Source: RBI and Union Budget, GOI.

Table 2: Select Fiscal indicators as percentage of GDP

Year	Tax Receipts	Interest Payments	Subsidies	Defense
1980-81	9.1	1.8	1.4	2.5
1990-91	10.1	3.8	2.1	2.7
2000-01	9.0	4.7	1.3	2.3
2010-11	10.3	3.1	2.3	2.0
2012-13	10.6	3.3	2.0	1.8
2013-14 (RE)	10.2	3.3	2.2	1.8
2014-15 (BE)	10.4	3.1	2.6	1.8

Source: RBI and Union Budget, GOI.

Table 3: Major Subsidies

(Rs. Crore)

Particulars	2012-13	2013-14 (RE)	2014-15 (BE)
Major Subsidies	247493	245452	251397
Fertiliser Subsidy	65613	67972	72970
Food Subsidy	85000	92000	115000
Petroleum Subsidy	96880	85480	63427
Interest Subsidies	7270	8175	8313
Other Subsidies	2316	1890	947
Total Subsidies	**257079**	**255516**	**260658**

Source: RBI and Union Budget, GOI.

means and an overall economic growth.

In view of the fact that a large proportion of the population in India depends on agriculture and allied sector for their livelihood, especially in the rural areas, the Budget has emphasised need for measures to make farming a competitive and profitable activity. The provision of Kisan Television, Warehouse Infrastructure Fund, Price Stabilization Fund, Kisan Vikas Patra (KVP), and Long Term Rural Credit Fund in NABARD and intention to usher in second green revolution with focus on higher productivity are clear indicators of sincere efforts to encourage agriculture sector in the economy.

Housing, construction and real estate are core sectors for economic growth. This industry holds potential to induce employment, promote demand and have a positive impact on other related sectors. With an objective to draw in large scale funding for the investment projects, the Finance Minister expressed intention of providing required incentives to the Real Estate Investment Trusts (REITS) and Infrastructure Investment Trusts (InvITs). As infrastructure projects typically have long gestation periods and substantial requirement of resources, REITS and InvITs may bring in the vital finances, including international finance to spur required growth in infrastructure.

India suffers from a severe shortage of housing, estimated at almost 19 million units in urban India in 2012. The central plan outlay for the Ministry of Housing and Urban Poverty Alleviation has been doubled and the Finance Minister has proposed establishment of a Mission on Low Cost Affordable Housing, to be anchored in the National Housing Bank (NHB).

One of the by-products of growth and development in the economy is the desire for a better standard of living and suitable opportunities. The development of a hundred Smart Cities and consequent modernization activity would positively impact real estate and overall infrastructure. This would also lead to higher investment in modern communication and in the process, infrastructure for telecom sector and information technology would get uplifted.

The announcement of flexibility in coverage of items in goods and services tax (GST) implies that implementation would be smooth and quick. The uniformity of rates and ease in monitoring GST would be a win-win situation for the Centre and states. The pooled Municipal Debt Obligation Facility would not only widen the financing avenues for infrastructure projects and the municipalities but also aid in strengthening of local bodies. The Swachh Bharat Abhiyan would have a positive impact on health of Indians, and especially reduce child mortality rate, as it would directly help to control diseases like diarrhoea.

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Economic Impact of the Budget

To analyze the impact of the Union Budget, consider the key economic issues that plague the economy and were widely debated during the electioneering period - economic growth, employment and inflation. The budget addresses these three issues rather seriously.

The growth in the country would get an impetus because of encouragement to the housing and construction sector through various schemes like real estate and infrastructure investment trusts, tax incentives for housing, and higher allocation for affordable housing through NHB, allocation for smart cities, and new airports in tier 1 and tier 2 cities. As housing has inter-linkages with 269 industries, industrial production would contribute to increasing growth. These growth enhancing measures would positively impact employment situation in the country. In addition, measures to encourage tourism, would directly add to employment in hotel, entertainment, transport and aviation industry, besides other commercial activities.

The Financial Inclusion Mission to be launched on August 15, 2014 for empowering weaker sections of the society, especially in the rural sector would help in expanding financial services to the poor. The use of technology at the back-end of the operations imply a trigger in employment generation in the banking sector in terms of opening of accounts, spreading financial literacy and increasingly providing financial services across the rural country-side.

In addition, there are two more measures which though welfare oriented would contribute to increasing employment like the increase in foreign direct investment in insurance. Insurance penetration, measured in terms of insurance premium to GDP, is less than 4 per cent in India despite numerous efforts by the government in the last decade, including permitting private insurance companies to operate in India. The potential to extend insurance from less than 25 per cent of the population currently covered under life insurance implies more employment opportunities in a young demographic country like India.

The country with a very young and dynamic population has found simple decisions like having a War Memorial or Statue of Unity very nationalistic. These could be developed as national monuments and places of tourism to encourage commerce and employment. The immediate setting up of new IITs, IIMs, AIIMS, agriculture and horticulture universities with a laudable long term objective of having premier educational institute in every state would give boost to youth employability in India and abroad.

In the last few months, it has increasingly become apparent that inflation in India, especially food inflation is a supply side phenomenon and not caused by loose monetary policy. To address the supply side concerns, agriculture and rural sector activities like warehousing have been encouraged. The announcement to reform Food Corporation of India and the working of public distribution system to plug leakages would help in containing agricultural prices, responsible repeatedly for inflation in India.

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Suggestions on Policy Issues

This is a unique Budget which has attempted to infuse a sense of participation in reviving the growth process in the economy. Therefore, a few suggestions in implementation of various schemes are offered –

a) With regard to the food subsidy, the delivery mechanism of channelizing the food to the section actually deprived of food and nourishment would require enhancing the role of local authorities. The local authorities' domain knowledge of the local areas should be taken advantage of, in order to identify the truly needy.

In absence of unique identity number of every Indian, special care would have to be exercised so that there are no leakages in credit proposed to be extended to unbanked households through these new accounts.

b) The reintroduction of Kisan Vikas Patras (KVP) would need careful consideration as during the previous KVP term, there were instances of massive participation by non-kisan individuals. Therefore, this reintroduction may attract numerous discussions on the actual feasibility and utility of the financial instrument.

c) The Financial Inclusion Mission with two bank accounts per household and an initial credit of some amount may be successful in familiarizing the non-banked but can be fraught with vulnerabilities. In absence of unique identity number of every Indian, special care would have to be exercised so that there are no leakages in credit proposed to be extended to unbanked households through these new accounts.

d) The revamping of the existing PDS could also take into consideration distribution of new goods through more than five lakh fair price shops like soaps for better hygiene, and essential medicines and equipment like mosquito nets for healthy living.

e) The expenditure incurred under corporate social responsibilities (CSR) could be tapped effectively for purposes of growth and employment though it is a philanthropic activity for community development. As per the Companies Act 2013, specified companies are required to utilize 2 per cent of their profits for CSR activities. CSR norms are applicable to companies having a minimum net worth of Rs. 500 crore or turnover of Rs.1,000 crore or net profit of Rs.5 crore in a financial year. The activities eligible for CSR are wide ranging and CSR activities by the respective company can be implemented through various methods on their own or by out-sourcing to non-profit organizations. According to industry sources, about 6000 companies in India would be required to undertake CSR activities as well as many small and medium enterprises earning net profit of more than Rs 5 crore. The estimated amount under CSR ranges from a conservative Rs.20,000 crore to nearly Rs. one lakh crore. Therefore, for effective utilization of CSR in nation building, the government may like to consider an accounting or regulatory authority to direct resources in specified areas.

f) The announcement of additional debt recovery tribunals (DRTs), in the face of mounting non-performing assets, should help in planning and hastening an appropriate revival course of action. The need is to strengthen DRTs to make them more effective. Also, there is a general feeling amongst the banking community that DRTs are consumer friendly and have not been successful in substantial amount of recovery for the banking system.

g) The objective of educating youth through setting up of new institutes and universities could be strengthened if foreign universities are also allowed to operate in India. Further, as youth from India find unique ways to migrate abroad but then due to lack of education and training suffer in low paid jobs, the government could consider specific skill formation and facilitating youth migration to respective countries in need of manpower. The Universities from these respective countries requiring manpower could be invited to India to train our youth in soft skills and necessary professional activity. Such well-trained migrants would serve two important functions, one as a brand ambassador of the country and the other, as a rich source of remittances.

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Conclusion

The Union Budget deftly crafted in about six weeks by a strategic thinker and seasoned parliamentarian has followed a very pragmatic approach of Maximum Cooperation and Minimum Resistance. And that probably is a correct strategy in a difficult economic situation, both internationally and domestically.

In recent months because of the mounting CAD, restrictions on gold imports were severe and the expectations from the new government were in terms of easing of import duties and facilitating revival of gold market. However, gold had virtually no mention in the much awaited budget of July 2014. The Finance Minister could have used this opportunity to explain the policy stance of the government on gold.

Further, there is one silent segment of the population, the elderly, which gets neglected in most of the policies of the government. There are more than 11 crore elderly in India, above the age of 60 years, generally female, who are in urgent need of care as nearly ninety per cent of them, associated with the unorganized sector, are not on any sustainable social security program. While some 3 crore elderly who are under the BPL category get about Rs 500 as old age pension, the remaining 8 crore elderly have to fend for themselves. In view of the weak and inadequate public health care system, the elderly have limited access to medical services as many research studies have discovered. In contrast to many countries in Europe, where age related expenditure on health and care is 8-10 per cent of GDP, it is less than 1 per cent in India. Some simple initiatives to help elderly could include respectable amount of universal pension and universal insurance to help them live their sunset years with dignity. The universal pension could increase with age and especially for female survivors. Finally, there is a need to address two things in connection with changing demographics in India. First, there is a need to have a think tank dedicated to ageing to study the problems of elderly and age related financial economics. Second, there is a need to develop science of medical gerontology, an area which is neglected in India.

The Union Budget of the new government may seem to be a continuity of the previous government but has much to offer when analytically examined. If implemented, it will usher in a change in the very fabric of Indian policy making and business thinking in a very short time because it proposes widespread changes in different segments of the economy.

The Finance Minister has correctly adopted an approach to demystify the Union Budget, much in keeping with the international practice followed by other countries where the budget day is a non-event and fiscal policy making is a regular feature, not identified with statement of government accounts. The announcement that monetary policy measures and other welfare oriented issues like malnutrition would be addressed separately as well as gradual rationalizing of the government expenditure like subsidies through a Commission indicates a focused approach towards fiscal issues, given the limited time-frame within which the budget was prepared. The resistance for additional borrowings and incurring higher debt obligation, despite the available fiscal space, demonstrates the commitment to fiscal consolidation. A sober and mature approach has been used in formulating the budgetary policy despite a mandate which would have helped rationalize if not justify fiscal profligacy. The budget, in that sense, is truly laudable and path breaking and sets a way for more reforms through consensus building. ❑

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