Budget 2010 – A few Challenges

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01.00 Important Aspects

The focus of Union Budget of 2010 is on three important aspects of the economy viz. quick return to the economic growth trajectory, fiscal consolidation and inclusive growth. It has clearly been an attempt to reconcile two equally pressing considerations—economic growth and financial consolidation. While growth is essential to have a larger cake to share, financial consolidation is needed to ensure that the gains do not dissipate as a consequence of skewflation.

The budget has sent clear signals to the effect that increase in consumption and private savings would be the priority of the day. The biggest move has been the recasting of personal income-tax slabs and allowing tax free investment in infrastructure bonds. The move is expected to increase the disposable income to the extent of Rs 56,000 each in the hands of over 3 crore taxpayers and thus boost consumption. The Budget, in general, has touched people across all income levels, for example by extending the deadline for farm loan repayment (under debt waiver scheme) and raising the subvention for timely repayment of crop loans from 1 per cent to 2 per cent for FY11.

There are, however, a few major challenges – some tangible and others intangible -before the government that need to be tackled with due diligence and integrity. An important one outlined by the Finance Minister in his budget speech relates to the weaknesses in government systems, structures and institutions at different levels of governance. The FM adds on to say that if there is one factor that can hold India back in realising our potential as a modern nation, it is the bottleneck of our public delivery mechanisms. He emphasizes that we have a long way to go before we can rest on this count.

Two obvious bottlenecks in the government systems are leaky buckets and unsustainable expenditures. A latest estimate on black money pin points that the existing tax revenue of Rs.5,34,000 crore can move up to a mind boggling to Rs.12,50,000 crores if the government can devise a means of channelizing this money into the main stream. The proposals relating to DTC and GST, when implemented, are expected to tap a substantial portion of this unaccounted chunk.

02.00 Cost of Governance

An important parameter that may unravel the unsustainable government expenditure is the cost of per capita governance. The population in India has grown by 41.84% during the last 20 years whereas the cost per capita governance of the union government has shot up from Rs.1255/- in 1990-91 to Rs.9317/- by 2010-11 reflecting an increase of a huge 953%.

The cardinal principle is that the increase in the cost of governance shall be directly proportional to the increase in population with appropriate adjustments for price index. Assuming a price increase of 250%, the logical increase in per capita governance should be pegged at Rs.2568/- for 2010-11 as against Rs.9317/- being born by us. In other words every Indian is put to carry on an additional burden of Rs.6749/- towards the uncontained cost of governance. Apart from zero based evaluation, stringent performance & social audits rather than the expenditure audits may help substantial containments in unproductive expenditures.

03.00 Alarming Fiscal Deficits and Public Debt

Another important area of concern to the Indian Economy is the alarming growth in Fiscal Deficits and Public Debt. The Economic Survey highlights that the fiscal deficits in India are dominated more by structural features and less by cyclical components. Therefore, the rapid and significant fiscal consolidation achieved in the post- FRBMA period up to 2007-08 was indeed an important achievement that enabled greater fiscal space for a macroeconomic policy stance to counteract the impact of the global economic crisis. Besides, as a proportion of the GDP, the reductions in fiscal deficit in the period 2003-04 to 2007-08 were made possible in equal measure by higher tax revenues and expenditure compression. This facilitated use of both tax and expenditure measures in the expansionary fiscal policies to boost demand. As such, the progress in fiscal consolidation in India is considered to be different from the typical models elsewhere driven purely by expenditure compression.

The resurgence of abnormal Primary Deficits since 2008-09 has, however, led to a reversal of the declining trend in the Debt-GDP ratio, and raises severe concerns about the sustainability of Public Debt in near future. The total Internal Liabilities of the Central Government are put at Rs.34,98,452 crore, working out to 56.75% of the GDP, as of 31st March 2010.

The rise in public debt means three major implications:

(a) The concomitant interest burden absorbs an increasing proportion of revenue receipts. The interest payments work out to 36.45% of the revenue receipts for the financial year 2010 -11.

(b) The rising level of borrowings casts an upward pressure on interest rates, crowds out interest sensitive investments in the short run and thereby adversely impacts the economic growth.

(c) The substantial additional borrowings add to the repayment burden and may result in the problem of frequent debt rollovers.

The bare financial fundamentals warrant that the Gross Fiscal Deficit should lead to Incremental GDP and in turn Incremental Revenue Receipts. These incremental receipts should be sufficient to cover the Interest Cost of the Deficit and as also the repayment of the borrowings within a reasonable time frame. In other words, the Revenue Receipts attributable to the Incremental Gross Domestic Product (IGDP) should be adequate to service the incremental interest payments and repayment of the relevant debt installment. Thus the vital

Equilibrium that should be targeted by any Finance Minister is "Revenue Receipts attributable to IGDP shall be equal to or greater than Annual Interest Cost plus Annual Debt Installment." The Indian story of deficits completely ignores this principle of equilibrium.

In the process, the cumulative impact of the fiscal deficits and the public debt has lead us to an Interest Burden of 37 paise of every rupee being earned in 2010-11. There could be no respite unless & until the bare fundamentals are appreciated and stringent strategies advocated by the Finance Minister.

If the debt-servicing burden is contained, there could be larger amount of resources spared for vital sectors such as health, education, social welfare and other needy avenues of the economy. This is especially so since almost the entire quantum of borrowed funds is being used for financing current consumption. Moreover, a disproportionate burden of debt is being shifted on to the future generations by excessive growth in public debt and rising debt servicing burden.

A clear roadmap to achieving fiscal consolidation will send the right signals to the global community and is a step in the right direction towards earning improved sovereign credit ratings for the country. Although the fiscal policy enunciated by the Central Government is committed towards reducing the fiscal deficit and debt to a sustainable level, such a commitment is not backed by specific actions that would ensure compliance and enforcement by the Government.

04.00 Window Dressing

Every Finance Minister attempts his best to window dress the budget by underplaying expenditure items such as fertilizer subsidy or petro bond liability or down plying the borrowings by excluding small saving loans and so on.

The revenue deficit of Rs.2,82,735 crores projected in the budget estimates for 2009-10 has shot up to Rs. 3,29,061 crores in the revised estimates furnished now. The deviation of Rs.46,326 crores between the budget estimates and the revised estimates is worrisome. The contributing factors to this huge increase in the deficit mainly consisted of Rs.37,203 crores of shortfall in revenue receipts coupled with excessive revenue expenditure o Rs.9,123 crores. Such of these deviations reflect the inability of the budget controllers to achieve the targeted goals and affects the integrity of the Budget severely. As a result the sanctity of the budget stands diluted.

Looking at the other way, the union budget is expenditure driven and is a commitment for the nation. The burden should be shared by every citizen in an equitable manner within the canons of economy, ability and transparency. In the absence of adequate transparency and a suspicious secrecy surrounding the Indian Budget, the canons of economy and ability are severely impaired pushing up the cost of governance.

05.00 Suggestions

The 13th Finance Commission has recently recommended that "tweaking tax and duty rates annually" should be stopped and they should switch to a "three-year rolling budget". A rolling budget means that tax and duty rates would remain unchanged for a longer period. This would help the companies and individuals to plan their financial strategies better. It would also improve the quality of government expenditure. Many developed countries follow a similar practice. It is time that India moves on to such a system which will amount to a stable tax regime for a reasonable period. In essence, such a rolling budget will make good sense for stability and planning.

In the ultimate, good governance should consist of five basic components i.e. political accountability, free market, the rule of law, social justice, and education. The government that rules and controls the nation, therefore, has to be properly streamlined. We should, in fact, learn from the experience of the East Asian countries, and try to be honestly 'hard' rather than being dishonestly 'soft'. In the process of achieving the aim of Inclusive growth the fear is of unfair exclusion and unjustified inclusion. The present growth strategy seems to be-consumption driven and not investment driven.

Therefore, it is important to simplify tax laws, be it be Direct Tax Code or GST, plug in the leaky buckets and spread out the age old Indian Ethics and bring down the per capita cost of governance to sustainable levels which will go a long way in expenditure containment and national prosperity.