Budget 2012-13: Treading a Middle Path

The budget 2012-13 was presented amidst ambitious expectations of achieving fiscal consolidation and providing growth impetus. Indeed, deterioration in fiscal situation and slowdown in growth rate needed tough decisions and budget was supposed to provide enabling signals. The budget, however, seems to have treaded a middle path without presenting over-optimistic estimates and major macro-fiscal decisions are left to be taken in the future. The macroeconomic and fiscal challenges were elaborated unambiguously in the Economic Survey – 2011-12 presented in the Parliament on the eve of budget. The Indian economy is estimated to grow by 6.9 % in 2011-12, after having grown at the rate of 8.4% in each of the two preceding years, primarily due to slowdown in industrial growth. Rising cost of credit and weak domestic business sentiment, added to this decline. The other macroeconomic policy challenge has been the high inflation, as measured by the wholesale price index (WPI), and the effect of monetary policy during the year to control inflation and curb inflationary expectations. India's inflation is largely structural, driven predominantly by agricultural supply constraints and global cost push. The current account deficit, which is 3.6% as a proportion of GDP in 2011-12 along with reduced net capital inflows in the second and third quarters, put pressure on the exchange rate. The weak growth scenario adversely affected the revenue collection of the central government, which has remained below expectations. Weak revenue position along with higher expenditure outgo, mostly on account of higher than budgeted subsidies, has accentuated the fiscal imbalance. Can the budget bring in the required changes? Read on to know more…

Dr. Pratap Ranjan Jena

(The author is Associate Professor, National Institute of Public Finance and Policy, New Delhi. He can be reached at jena@nipfp.org.in)

Deteriorating fiscal situation since 2008-09 continued to pose severe challenge to the economy. Rising fiscal deficit and consequent increase in Government borrowing adversely effects the private investment due to crowding out, stokes inflation and dents efficacy of the monetary measures to control inflation. The scrutiny of fiscal data indicates that significant improvement in the fiscal situation at central level in the mid-2000s was mainly revenue driven, particularly due to income tax, riding high on buoyant economy and modernisation of tax administration. The real test of the fiscal discipline came during 2008-09, when the national growth rate slowed down sharply

to 6.8% from an average of 9.4% in the preceding three years, because of the international financial crisis. This has triggered an expansionary fiscal stance by the Central Government through fiscal stimulus packages comprising both tax cuts and expenditure hikes. The sharp upsurge in deficits in 2008-09 was accentuated by spending on pay revision, increased subsidies, expansion in the scope of the National Rural Employment Guarantee Act and introduction of farm loan waiver schemes. Since 2008-09 the fiscal imbalance at Central level has further deteriorated as is evident from the 2011-12 revised numbers of 5.9 of fiscal deficit as against budget estimate of 4.6% relative to GDP, a slippage by 1.3 percentage points. The fiscal deficit of this magnitude is a concern as it is going to vitiate investment climate and growth prospects.

Table1 Trend in Deficits of Central Government

Year	Revenue Deficit	Fiscal Deficit	Primary Deficit
2004-05	2.4	3.9	0
2005-06	2.5	4.0	0
2006-07	1.9	3.3	-0.2
2007-08	1.1	2.5	-1
2008-09	4.5	6.0	2.6
2009-10	5.2	6.5	3.2
2010-11	3.3	4.9	1.8
2011-12(BE)	3.4	4.6	1.6
2011-12 (RE)	4.4	5.9	2.8
2012-13 (BE)	3.4	5.1	1.9

Source: Union Budget Documents

The Government chose to restrain the fiscal deficit at 5. 1% in 2012-13 budget, which is even higher than that of the TFC targets of 4.2% of GDP. Although this level of deficit is more than the TFC fiscal path, the budget estimate looks reasonable as against projecting over-optimistic numbers like that in the last budget. The reduction in the level of fiscal deficit was based on the calculation of higher tax yields next year. The revenue growth that has gone into this estimate depends to a large extent on the projected growth of GDP at 7.6% for the next year. The excise and service tax rate was increased from 10% to 12%, a withdrawal of stimulus, and there was expansion of tax base. A negative list for service tax such as primary education, government services, renting of residential building, public transport, has been introduced, which implies all services other than those in the list can be taxed. The rate for corporation tax remained untouched and

The Government chose to restrain the fiscal deficit at 5. 1% in 2012-13 budget, which is even higher than that of the TFC targets of 4.2% of GDP. Although this level of deficit is more than the TFC fiscal path, the budget estimate looks reasonable as against projecting over-optimistic numbers like that in the last budget. The reduction in the level of fiscal deficit was based on the calculation of higher tax yields next year.

rejig in the income tax rates and brackets are however, projected not to cost the Government much. While custom duties for some infrastructure-related items were reduced, there were increases in other items like gold and cars. The budgeted excise and services taxes were projected to grow by 30% over the revised numbers. The net tax revenue for the Centre, after accounting for the States' share, is set grow by 20%, looks achievable if the growth projection of 7.6% holds good. Besides taxes, the other two items that is expected to facilitate fiscal consolidation are disinvestment proceeds of ₹30,000 crore and ₹42,000 crore from spectrum auctions. However, the budget does not elaborate the details about these. The big ticket tax reforms such as introduction of Goods and Services Tax (GST), and Direct Tax Code (DTC) were left for a future date. The budget indicated that the DTC Bill would be enacted at the earliest after expeditious examination of the report of the Parliamentary Standing Committee. On GST, it was said that the model legislation for Centre and State Goods and Services Tax (GST) in concert with States was under progress and the GST network would be set up as a National Information Utility, which would become operational by August 2012.

Expenditure restructuring by controlling some major items like subsidies could have provided much needed relief in the quest to achieve the fiscal consolidation. The aggregate expenditure was raised by 13%, while the capital outlays were raised by more than 30% as against the revised estimates of 2011-12. However, as percentage to GDP the capital outlay at 2% was projected to touch only the 2010-11 level. It is clear that the inability to control subsidies propelled the fiscal deficit to such a high in revised estimates. The revised estimates of subsidies were higher than the budgeted estimates by ₹72,727 crore and it was budgeted to come down by ₹26,281 crore in 2012-13. The Finance Minister was emphatic in his concerns about subsidies and made the announcement that subsidies would be limited to 2% of GDP next year and eventually would be brought down to 1.7% in the next three years. The intents are laudable. But budget for 2012-13 does not

provide a clear action plan as to how this objective could be achieved. Looking at the components of subsidies, food, fertiliser and petroleum, it is not very obvious that the intents would result in outcomes. The relatively small rise in food subsidies, by about ₹2,177 crore looks tiny as compared to purported estimates of Food Subsidy bill that may come well above ₹30,000 crore. Lower assumption of crude oil price in budget estimates of 2011-12 resulted in higher spending by about ₹45,000 crore in revised estimates. The petroleum subsidy budgeted to decline by about ₹25,000 crore does not look very promising given the surge in crude prices and uncertainties in the Middle East. The lower allocation to this head of subsidy only suggests that the Government would undertake massive rise in retail prices of petroleum in the next year. The political environment does not look very conducive for this. The budget proposal to integrate Aadhar in targeting subsidies for fertiliser, kerosene and LPG directly to beneficiaries in at least 50 selected districts is showcased as way forward to contain the subsidies. The small rise in food subsidy, as alluded, and a 17% reduction in the budgetary outlay for NREGA will be of some help. The use of IT system as envisaged in Aadhar programme could be argued to improve service delivery; its impact on reducing aggregate subsides given the impact of other components is doubtful.

The long-awaited amendments to Fiscal responsibility and Budget Management Act was introduced in the Finance Bill 2012 reflecting the commitment of the Government to achieve the fiscal consolidation. The amendments set the new goal post to achieve the fiscal consolidation at 31st March 2015, as suggested by the TFC in their fiscal restructuring plan. Instead of targeting a zero revenue deficit, the amendments aim to eliminate 'effective revenue deficit', which was estimated to be 1.8 % of GDP in budget estimates for 2012-13, that excludes grants given to the States for creating capital assets. Accordingly the revenue deficit will be reduced to 2% by 2014-15 from the budgeted level of 3.4% and the fiscal deficit will be reduced to 3.9% of the GDP from the estimated 5.1% in

Expenditure restructuring by controlling some major items like subsidies could have provided much needed relief in the quest to achieve the fiscal consolidation. The aggregate expenditure was raised by 13%, while the capital outlays were raised by more than 30% as against the revised estimates of 2011-12. However, as percentage to GDP the capital outlay at 2% was projected to touch only the 2010-11 level.

The long-awaited amendments to Fiscal responsibility and Budget Management Act was introduced in the Finance Bill 2012 reflecting the commitment of the Government to achieve the fiscal consolidation. The amendments set the new goal post to achieve the fiscal consolidation at 31st March 2015, as suggested by the TFC in their fiscal restructuring plan. Instead of targeting a zero revenue deficit, the amendments aim to eliminate 'effective revenue deficit'.

2012-13. These targets numbers are higher than the TFC suggested fiscal targets. This implies the recognition of fiscal realities by the Government while fixing the fiscal targets. The key feature of the FRBM Act amendments is the flexibility element that the Government specified in the process of fiscal consolidation. The unforeseen contingencies such as the Eurozone debt crisis or rising oil prices due to unrest in the Middle East would provide flexibility to the Government in defining the achievable targets in a three-year rolling Medium Term Expenditure Framework. While for the success of any fiscal rule political commitments are necessary, reasonably high growth is essential. Maintaining fiscal discipline is reasonably easy when the economy is strong and it becomes challenging under adverse conditions. But too much of flexibility in the process provides the pretext to breach the rules in any circumstances. For successful observance of fiscal rules, it becomes incumbent upon the Government to perform better in terms achieving lower fiscal deficit than adhering to the targets during the growth phase. Believing that higher revenue collections would continue interminably and support the future year budget commitments may not be in the interest of a sound fiscal management.

The budget emphasises on infrastructure and industrial development keeping the broad objectives of 12th five year plan in consideration. The budget put forth a number of proposals to facilitate reducing the cost of funding for the infrastructure and some other core sectors. It was proposed to provide ₹15,888 crore for capitalisation of Public Sector Banks, Regional Rural Banks and other financial institutions including NABARD. Lowering withholding tax on external borrowings (ECBs), permitting ECB for working capital requirements of the Airline Industry, allowing ECBs for low cost housing, allowing road sector to access ECBs even for rupee expenditure, removing sector restrictions for venture capital, doubling the allocation for tax-free infrastructure bonds market are other key budget proposals to ease availability of funding for infrastructure sectors. These measures reflect the

Government's move to drive private sector to get funding from abroad. This kind of policy poses the dilemma between developing domestic capital market by lowering the cost of borrowing and seeking funds abroad. The capital market is still not free from barriers and the level of access to the foreign funds is not very clear. Calling for strengthening investment environment, the budget states that efforts are on to arrive at a broad-based consensus in respect of decision to allow FDI in multi-brand retail up to 51%. The political environment to accept the FDI in multi-brand retails, however, is not ripe at the moment.

The budget for 2012-13 dwells at length in supporting the agricultural sector and other social sectors. Stating that agriculture will continue to be a priority for Government, the budget proposed an increase by 18% to ₹20,208 crore in the total Plan Outlay for the Department of Agriculture and Cooperation in 2012-13. The outlay for Rashtriya Krishi Vikas Yojana (RKVY) was increased to ₹9,217 crore in 2012-13. Underlining importance of timely access to affordable credit for farmers, the budget proposed to raise the target for agricultural credit to ₹5,75,000 crore, which represents an increase of ₹1,00,000 crore over the target for the current year. A short term RRB Credit Refinance Fund is being set up to enhance the capacity of Regional Rural Banks to disburse short term crop loans to the small and marginal farmers. It was proposed to modify the Kisan Credit Card Scheme to make it a smart card which can be used at ATMs. A National Mission on Food Processing is proposed to be started to have a better out reach of the food processing sector in 2012-13. The budget also proposed increase in funding for various social sectors porgrammes such as SC and ST sub plan, rural drinking water and sanitation programme, primary education, National Programme of Mid-Day Meals in schools, rural health mission, National Social Assistance Programme, and Pradhan Mantri Sadak Yojana. While raising resource allocation to various programmes under the social sector is important, what is more required is to spending the money responsibly, efficiently and effectively to get the results.

The budget for 2012-13 dwells at length in supporting the agricultural sector and other social sectors. Stating that agriculture will continue to be a priority for Government, the budget proposed an increase by 18% to ₹20,208 crore in the total Plan Outlay for the Department of Agriculture and Cooperation in 2012-13.

The budget aimed at achieving growth recovery, improving fiscal situation, revival of private investment, addressing supply bottlenecks, providing enabling environment for infrastructure, addressing social sector problems, and improving service delivery systems and governance. Although the budget decides on resource allocation to various sectors on the basis of which its efficacy is evaluated, the policy signals that come out of the budget have considerable importance in serving the objectives. While the budget 2012-13 avoided big bang approach to facilitate ushering in major reforms to push the economy ahead, it had some positive features. The idea of cash subsidies, some tax reform measures like introducing a negative list in case of service taxation, expanding the tax base, raising tax rates in the case excise and customs, aligning with tax slabs indicated in DTC, not being over-optimistic as regards fiscal deficit, making attempts at reducing cost of funding for infrastructure are some such elements. The major reform measures were, however, kept in abeyance and political commitment will probably decide their fate.

A final point regarding the role of budget and how much of it is acknowledged in recent years is in order. Annual budgets are analysed and debated more from the point of view of achieving fiscal sustainability. This was reinforced due to the fiscal stress experienced during the late nineties and recently after 2008 global financial crisis and consequent slowdown. Budget management in these circumstances has been construed as an exercise to address the issues like controlling fiscal deficit and government borrowing to limit their adverse impacts. Although fiscal discipline and macroeconomic balance remains paramount, the role of the budgeting system in enhancing prioritisation for allocative efficiency, improving public service delivery, ensuring citizen responsive decisions, and accountability of administrative departments in spending public money needs to be acknowledged. To meet the requirements of allocating resources in accordance with the strategic priorities, efficient and effective use of resources to implement the programmes, and evaluating the results are significant in this context. Judged from these aspects, the budget for 2012-13 remains conventional where resource allocations are indicate. It is still a long road to find answers to the questions relating to basis of budget decision making and accountability for performance of the Government. ■