Overview of Macroeconomic Aspects of Budget 2013-14

The budget for the year 2013-14 was presented when the economy was in a downtrend and was experiencing severe fiscal stress. The growth rate had declined from 9.3% in 2010-11 to a projected level of 5% in the current year. The third quarter GDP growth was even lower at 4.5%. The macroeconomic indicators like surging current account deficit, high inflation, declining savings and investment rates, and falling consumption, indicate the deep malaise into which the Country has slipped. The political atmosphere was charged with looming elections in 2014 and expectations of a budget catering to populist demands both on tax and expenditure fronts. Under these circumstances, the budget for 2013-14 was presented with expectations of achieving fiscal consolidation, providing impetus to economic growth and stimulating investment. By desisting from giving in to the pre-election expenditure demands and tax cuts, the budget 2013-14 made a sensible approach to the economic management. Achieving fiscal consolidation was given top priority, to provide an enabling environment for revival of the economy. The emphasis on growth to deliver the socio-economic development, has been the core theme of the budget. Read on to know more…

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In the Union Budget for 2013-14, while concerted attempt was made to lower the fiscal deficit in 2013-14, the budget provides resources for inclusive social development. It has facilitated avoiding a downgrade from the rating agencies that would have resulted in immediate outflow of foreign investment. The impact of this budget on improving growth rate and achieving

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the fiscal targets, however, will depend upon the overall governance and effective implementation of the Government's plans and policies.

After recovering from the slowdown in 2008-09 due to the global financial crisis, the Indian economy managed to achieve a growth rate of 8.6% and 9.3% respectively in 2009-10 and 2010-11. The fiscal and monetary stimulus provided by the Government played a crucial role in the recovery process. However, the sharp decline in the next two years and particularly to a low of 5% in 2012-13, speaks volumes about the management of the Indian economy. The industry sector declined to 3.5% and 3.1%, services declined to 8.2% and 6.6% in 2011-12 and 2012-13 respectively. The despondency is clear and deterioration is unambiguous. The Economic Survey for the year 2012-13, which rather gave an impartial view of the State of the economy, indicated several factors that contributed to this decline. The considerable decline in private final consumption expenditure from 8% in 2011-12 to 4.1% in 2012-13, due to higher inflation had adversely affected the production sector. The stronger monetary policy since 2011-12, as the RBI started raising policy rates to rein in inflation, made it difficult for private investment. The corporate and infrastructure investment started slowing down due to high policy rates and other investment bottlenecks. The external factors such as downturn in the global economy due to crisis in Euro area and fiscal uncertainties in the United States have had their impact on India's economy as well due to slowing export growth. While external factors explain part of the story, the lack of clear policy interventions and large-scale governance problems that bugged down the decision making process during the last few years should also be stated in this context.

The deterioration in growth rate needs to be understood from the point of view of a sharp drop in saving and investment, which also aggravated the current account imbalance and fiscal deficit. The spectacular rise in domestic savings from an average of 23% of GDP in 1990s to 36.8% in 2007-08 highlights the impact of the fiscal consolidation and growth during that period. The gross domestic savings have eroded since then, to reach a level of 30.8% in 2011-12. All its three components, viz. households, the private corporate sector, and the public sector show decline during this period. There was also a compositional shift in household savings from financial savings to physical savings in gold and real estate to circumvent the effect of inflation. Lower returns and higher volatility on financial savings in the recent years coupled with high inflation, affected the preference of the household to gold as a safe haven. When household savings were declining, the slowdown in the industrial sector also resulted in falling private corporate savings. The public sector savings that played crucial role in the growth phase, eroded sharply from 5% to GDP in 2007-08 to 1.3% in 2011-12, as the Government provided larger resources through fiscal stimulus in response to the global financial crisis. The gross capital formation, which is the combination of the public and private investment as share of GDP, slowed down to 35% in 2011-12 as against 36.8% in 2010-11. The sharp decline in the private investment could be attributed to increase in policy rates, lower demand for Indian exports, and the deterioration in investment environment. Many large projects are stalled due to several bottlenecks that include environmental permissions, fuel linkages, or carrying out land acquisition. The economic survey rightly prescribes to adopt policies to ease the investment climate, pursuing structural reforms investment, and adopting accommodative monetary policy, as inflation abates to encourage productive investment.

The gap between savings and investment, the former shrinking sharply, has resulted in widening current account deficit (CAD). The CAD has increased from 2.8% to GDP in 2010-11 to 4.6% in 2012-13. The Government's effort to discourage gold imports by raising the tariff from 4% to 6% has not helped much. With export growth falling sharply, which

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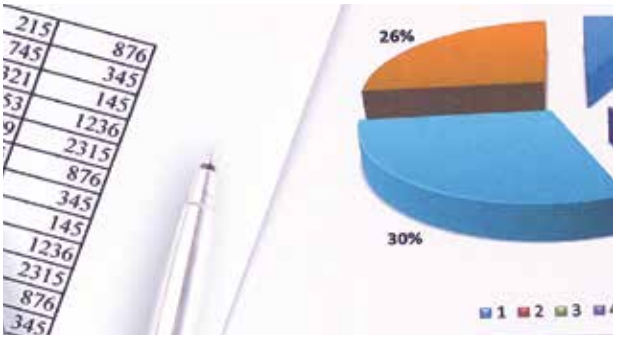
has become negative in 2012-13, the pressure on the balance of payment is only going to grow. As the growth in exports will depend heavily on economic performance of industrial countries, the options to correct BoP imbalance and reducing CAD are few. Lower inflationary pressure, however, will bring in some stability by reviving domestic investment.

One of the major macroeconomic challenges facing the country has been the high inflation that vitiated the private investment climate stalling the growth prospects and heaped misery on common people. Headline WPI inflation, although moderated from a high of about 10% in 2010-11, remained at 7.6% in the current financial year. The CPI inflation in which the food price is the primary component, however, remained unabated at 10% due to very high food inflation. Higher food inflation was attributed mostly to supply side constraint in terms of lower production of key food grains and structural bottlenecks. This has the tendency to fuel the headline inflation upwards. Moderating food inflation remains important, as the monetary intervention through higher policy rates to combat the inflationary pressure, has worked adversely on the growth front. The higher CPI inflation influences the public perception regarding the credibility of the Government's ability to manage the economy and particularly controlling the prices. The Government's approach to control the inflation usually should be through fiscal consolidation and removing the supply bottlenecks as the scope for controlling the food inflation through monetary policy is limited. Easing supply side constraints and removing structural bottlenecks, are easier said than done as controlling factors like production pattern, policies on prices and procurement, and behavior of monsoon, cannot be achieved in a short run. Inflation, however, needs to be abated, to allow the RBI lower the policy rates, to rejuvenate the investment sentiments.

Achieving fiscal consolidation after the difficult years of 2008-09 and 2009-10 when the fiscal deficit increased to 6% and 6.5% of GDP respectively, has remained the biggest challenge for the Government. Improvement in fiscal situation in 2010-11 along with improved growth performance riding high on Government's stimulus package, saw the fiscal deficit declining to 4.8% of GDP. As the growth declined after that, the fiscal deterioration persisted for the next two years. The fiscal deficit widened to 5.7% of GDP in 2011-12 and the Fiscal Responsibility and Budget Management (FRBM) targets were summarily breached. The declining collection of central revenues due to slowing industrial activities and outputs and continued pressure on expenditure due to rise in subsidies in fuel, fertiliser, and food, exacerbated the fiscal problems. High fiscal deficit resulting in elevated level of Government borrowing tends to heighten inflation, reduces room for monetary policy actions, and dampens private investment. The Fiscal restructuring path chalked out by the 13th FC and accepted by the Government, which recommended reducing the fiscal deficit to 4.2% of GDP in 2012-13 and contain at 3% level thereafter, is certainly found to be unachievable. The Kelkar Committee in their fiscal roadmap to achieve consolidation, projected a rise in fiscal deficit to the extent of 6.1% in the current year in a business-as-usual scenario. The Committee's reform recommendations that included adopting GST, reviewing the Direct Tax Code, administrative measures to improve tax collection, adopting



The budget plays the right note by taking initiatives to boost investments in infrastructure and industry, where the growth has been declining. The proposal of an investment allowance at the rate of 15% to manufacturing companies that invest more than Rs.00 crore in plant and machinery is expected to improve the industry sectors.

new models for disinvestment, rationalisation expenditure by pruning subsidy, found favour with the Government. The Government announced a revised fiscal correction path by targeting the fiscal deficit of 5.3% and 4.8% of GDP in 2012-13 and 2013-14 respectively and reducing it by 0.6 percentage point to reach at 3% in 2016-17. While the fiscal correction path was stretched longer, even compared to that of the Kelkar committee's projections, achieving the targets depends heavily on the Government's ability to control the subsidies and achieving higher tax-GDP ratio. The slippage on public finance needs to be corrected to establish credibility of Government policies, to improve domestic savings to finance the investment. Prolonging the imbalance would put pressure on domestic savings and expand the CAD given a level of investment.

The budget for the year 2013-14, thus, was presented when the country has been facing several macroeconomic challenges. The budget seems to have taken a realistic approach, by refraining from being overtly populist when the general election is due in 2014-15. Fiscal consolidation and reviving investment climate have been the major focuses of the budget. On the fiscal front, a starting has already been made, as the fiscal deficit for the year 2012-13 was limited to 5.2% of GDP as compared to the budgeted level of 5.3%. Expenditure control during the final months of financial year 2012-13 seems to have resulted in controlling the fiscal deficit. The budget aims for 4.8% fiscal deficit in the year 2013-14, in line with the 'red lines' drawn before the budget announcements. This is expected to rejuvenate the confidence of the private sector and ward off the spending demands. Reversing the trend of rising subsidies by restricting it to 2% of GDP, at 2007-08 level, was the key element of planned fiscal consolidation. The fiscal math includes aggregate expenditure projected to grow by 16% and tax revenue by 19%, a full 2% higher than that of the current trend. The Government also expects higher income from disinvestments for which non-tax revenue grows sharply in the budget projections. While tax slabs remained unchanged, the higher growth of tax revenue would depend on a projected 13.5% nominal growth rate. Some other tax increases include a surcharge on income above ₹1 crore for a year, surcharge on companies, widening of tax base by applying TDS to the transfer of property over ₹50 lakh at a rate of 1%, and the commodity transaction tax. Rationalisation in tax laws relating to royalty is proposed to enhance the tax base. The commodity transaction tax is expected to create a level playing field between trading in equities and trading in non-agricultural commodities.

The budget plays the right note by taking initiatives to boost investments in infrastructure and industry, where the growth has been declining. The proposal of an investment allowance at the rate of 15% to manufacturing companies that invest more than ₹100 crore in plant and machinery is expected to improve the industry sectors. The progress in stalled infrastructural projects will make an improvement. In the sectors like textiles, leather, and electronics, several measures have been announced. The budget also stressed upon the financial sectors by introducing several regulatory measures and enhancing the possibility of infusion of additional resources. Particularly the focus on housing sectors is expected to boost low cost housing sector and related industries. The expansion of Rajiv Gandhi Equity Savings Scheme provides the scope for promoting capital markets and other measures are proposed to enhance the participation of FIIs. The budget also indicates that the recommendation of the Financial Sector Legislative Reforms Commission (FSLRC) will be analysed and implemented, which will introduce a number of reform measures in financial regulations. The budget also proposed to set up a Council of Experts to analyse the international competitiveness of Indian Finance and propose measures to improve it.

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Converting the intents to results is fraught with risks. The uncertainties regarding the World economy, current lack of momentum in the Indian economy and raging CPI inflation will continue to come in the way of many budget projections. The fiscal consolidation around which the revitalisation efforts are placed, will depend upon achieving the ambitious projections of revenues and expenditure controls. If the optimistic projection of 19% tax revenue growth does not materialise, the plan expenditure will have to be reduced to achieve the 4.8% fiscal deficit. The key will be the ability of the Government to control the subsidy bill to the projected level of 2% of GDP. The control on fuel subsidy is based on the arithmetic involving already decontrolled petrol price, cap on subsidised LPG and the expectation of some kind of settlement on diesel pricing linked to the market prices. The delay in settling issues relating to diesel pricing correction will further compound the scale of correction in future. The assumption that directing the fuel and food subsidies to eligible beneficiaries using Aadhar number will control the subsidy bill by removing corruption and irregularities may not fructify, given the fact that the cash transfers has not been expanded for food as yet. Fiscal consolidation is important, as it will bring in a virtuous cycle of lower government borrowing, accommodating monetary policy involving lower policy rates, improvement of investment climate due to lower interest rates, and growth. The fiscal discipline will enable the Government to fulfill many of it promises made in the budget relating to social sector development. On the other side of the fiscal story is the delayed infrastructure project worth thousands of crores due to many institutional bottlenecks that vitiates the investment climate. Although the Cabinet Committee on infrastructure has been constituted in July 2009, it has not made much headway to clear the mess surrounding the stalled projects. The new regulatory framework suggested in the budget in infrastructure sector needs to show the way. Thus, the proactive participation of ministries and departments other than the Ministry of Finance, in creating an enabling environment for investment is crucial.

Collecting revenue in non-distortionary manner and spending public resources responsibly, efficiently, and effectively are major activities pursued through the budget to achieve fiscal discipline, improving prioritisation for allocative efficiency, and establishing good operational management to deliver public services. The sound public financial management system gives emphasis to performance management both in terms of financial compliance through expenditure control and delivering quality public services. In recent years, accomplishing fiscal discipline and macroeconomic balance have remained paramount and budget management is construed more from the point of view of controlling fiscal deficit and government borrowing to limit their adverse impacts. The requirements of allocating resources in accordance with the strategic priorities, efficient and effective use of resources to implement the programmes, evaluating the results in a transparent manner, and establishing an accountability framework to achieve the results have remained in the periphery. The conventional budget, though indicates the resources allocated, gives little to understand the use of those resources to achieve certain agreed results. The Government of India has established the 'outcome budget', which are tabled by the departments separately in the budget session. The outcome budget signals the need to move beyond conventional line item budgeting system by converting outlays to outcomes. However, this requires measurement of realistic performance indicators and use of the performance information in resource allocation decisions. The building blocks of the outcome budget, measurement of performance indicators, specification of standards, costing of programmes, monitoring and evaluation system are still evolving in India. The outcome budget is yet to emerge as a robust fiscal instrument to influence the decisions over public finances and provide an accountability framework to judge the performance of the government in delivering the public services. ■