WP-2014-028

Budget 2014: Marginal realignment of tactics to strategy

Ashima Goyal

Indira Gandhi Institute of Development Research, Mumbai
July 2014
http://www.igidr.ac.in/pdf/publication/WP-2014-028.pdf

Budget 2014: Marginal realignment of tactics to strategy

Ashima Goyal
Indira Gandhi Institute of Development Research (IGIDR)
General Arun Kumar Vaidya Marg
Goregaon (E), Mumbai- 400065, INDIA
Email (corresponding author): ashima@igidr.ac.in

Abstract

The paper examines the restructuring of expenditure in the first budget of the new government, and its feasibility. It compares the increase in budget allocations for key macroeconomic aggregates and sectoral plan outlays for the BJP and UPAII interim budget, and the change from the interim budget. Although overall tactics are aligned to the strategy articulated, the alignment is only marginal as yet, because the various strands are not well integrated to tell a coherent story of how they work together, and changes are not quantitatively significant. This is unfortunate because the macroeconomic changes are aimed at raising growth and jobs. There are also small beginnings in better systems, incentives, composition of public spending and public services. Apart from contributing to growth these help improve equality through capacity creation so the economy does not hit sectoral bottlenecks, as happened with the past excessive share of consumption-inducing government expenditures. A performance in relation to a promise based index ranking of post reform governments shows that although the UPAII was worst, the first congress government was the best, with the BJP led NDA coming in third. So the BJP has to do better this time if it wants to improve its ranking.

Keywords: Budget; BJP; UPAII; strategy; restructuring; delivery

JEL Code: H62, H63, E62, E65

Acknowledgements:

I thank Reshma Aguiar for excellent assistance.

Budget 2014: Marginal realignment of tactics to strategy

Introduction

The first budget of a new government is expected to clearly communicate a vision and the plans for implementing it. The desire to meet aspirations through higher growth, employment, better amenities, infrastructure and governance is articulated, but how the measures in the budget are expected to help achieve it is not clarified.

This is unfortunate, because there are several ways in which, despite overall continuity, the budget does nudge towards change. Interacting aspects work consistently to improve outcomes, as the sections below show. Apart from growth enhancing macroeconomic changes, shifting equality-improving measures towards capacity creation will help ensure the economy does not hit sectoral bottlenecks, as happened with the past excessive share of consumption-inducing government expenditures. The changes do not, however, go far enough.

To examine the restructuring of expenditure in the first budget of the new government, the paper compares the increase in budget allocations for key macroeconomic aggregates and sectoral plan outlays for the BJP and UPAII interim budget, and the change from the interim budget. Comparison with past actual increases gives an assessment of feasibility. A performance in relation to promise based index ranking of post reform governments shows that although the UPAII was worst, the first congress government was the best, with the BJP led NDA coming in third. The BJP has another opportunity to deliver, but to improve its ranking it must do better this time.

Macroeconomic determinants of growth

At the macroeconomic level there is stimulus for different types of investment and for household saving all of which raise growth. Column 1 in Table 1 gives the percentage difference between the budget estimates (BE) of the BJP government and those in the interim budget. So it indicates the restructuring away from the UPA II budget. Column 2, with the increase in the 2014-15 July BE over 2013-14 revised estimates (RE), gives the expected increase in expenditure that will impact the economy. Column 3 has the similar promises UPAII had made in the interim budget. Column 4 is an indicator of the feasibility of the promises since it gives actual past performance—the change in 2013-14 RE over actuals of 2012-13.

Column 1 shows a sustained effort, in the current budget, to increase different types of productive expenditures, above what was promised in the interim budget. A substantial increase is promised (Column 2) compared to past increases (Column 4) in Plan revenue expenditure and in capital creation outside the plans—Non-plan capital expenditure, and in grants for the creation of capital assets.

Apart from the marginal turnaround in public investment, there are many measures to reverse the fall in private investment, and increase its productivity. This is essential to reverse the slowdown in manufacturing. These include temporary tax credits for investment, with eligibility for the investment allowance extended to an investment of Rupees 25 crores, from the earlier threshold of 100 crores. This will make many micro and small manufacturing enterprises eligible. There is an emphasis on PPPs and the promise of faster decision-making, even at local levels, through follow up with the States. An IT enabled e-BIZ single window is to coordinate central government services for industry, many industrial corridors and clusters are to be developed.

TABLE 1: Key budget figures (per cent increase)

	Restructuring	**Promises: BJP**	**Promises: UPAII**	**Feasibility**
	BE over past BE: BJP over UPAII	**BE increase over past RE**		**Past RE increase over 2012-13 actuals**
	1	2	3	4
Revenue deficit ratio	-3.33	-12.12	-9.09	-8.33
Fiscal deficit ratio	0.00	-10.87	-10.87	-4.17
Primary deficit ratio	0.00	-38.46	-38.46	-27.78
Non-plan capital expenditure	5.17	20.72	14.79	5.79
Total plan expenditure	4.00	20.90	16.80	14.97
Plan revenue expenditure	2.54	21.96	18.94	12.95
Plan capital expenditure	7.47	17.18	9.04	22.82
Total revenue expenditure	15.80	12.86	-2.54	12.77
Grants for creation of capital Assets	14.68	21.61	6.04	19.46
Non-plan revenue Expenditure	0.62	8.46	7.79	12.40
Of which				
Subsidy	1.94	2.01	0.08	-0.61
Social services (health, education, etc.)	2.03	-0.40	-2.40	20.17
Total capital expenditure	6.39	18.80	11.66	14.41
Revenue receipts	1.94	15.59	13.40	17.06
Capital receipts	1.52	7.83	6.22	5.66

Source: Calculated with Budget data available at indiabudget.nic.in

Promoting Foreign Direct Investment in strategic sectors such as defence production and insurance will also directly increase investment, domestic jobs, technology, and financing. FDI limits have been raised from 26 to 49% so that management and control remain with India. Other concessions have been given with respect to built-up area and capital conditions, especially for low cost housing, and for smart cities.

Additional finance for investment comes from measures to encourage household savings. Rise in the Public Provident Fund limit eligible for tax exemption, easier Know Your Customer norms and one single operating demat account will encourage financial savings. Instruments such as Real Estate Investment Trusts which will be given pass-through tax status and Public Sector Banks divestment to domestic retail are to bring households back into equity markets. Banks will find it easier to fund long-term infrastructure with the permission to raise long-term funds with reduced minimum Statutory Liquidity Ratio, Cash Reserve Ratio requirements.

The salaried classes who bear the largest tax burden are given some concessions, even as selected industries get excise concessions. These, apart from compensating for the erosion of tax brackets from inflation, will raise demand for industry. Investment and savings tax credits should repay by raising more taxes as they stimulate more growth.

Concrete action to reduce food inflation is limited to a promised sale of food stocks. But the budget does recognise the importance of working closely with States to modify the APMC acts, and promises other steps to improve agricultural marketing including improving warehousing and restructuring the Food Corporation of India. Interventions in agriculture are correctly focused on improving infrastructure—irrigation, watershed development, feeder separation in power, roads and housing. Allocations for NREGA are to be maintained but also directed towards asset creation. Facilitating credit into agriculture is to continue. A fund for village entrepreneurship can aid food storage and processing.

Last year fire-fighting reduced the current account deficit and strengthened the rupee, but increasing domestic financial savings and deepening domestic markets are important among longer term measures to maintain a sustainable balance of payments. While taking steps to deepen domestic financial markets it is good the finance minister has not further liberalized foreign debt flows. This should be done only after domestic supply constraints are removed. Improving the domestic business environment will also encourage exports. An export promotion mission is to be established, and special economic zones encouraged.

Resolving bottlenecks

In the UPA's budgets the composition of fiscal spending increased demand for a varied basket of food, while restrictions in agriculture prevented a matching supply response. Large government transfers for consumption added to inflation. The lesson follows that government spending on de-bottlenecking the economy and releasing restrictions on the supply response could be very effective. The quality of fiscal consolidation, therefore, is more important than just reducing spending. Second, transfers should be commensurate with expansions in capacity.

Two factors limit the increase in public investment. First, it takes time to ramp up the system to spend effectively, particularly if the direction of spending has to be changed. Second, the funds constraint prevents a rise in public investment unless there is a fall in other government expenditures. The budget's attempts to change the composition of government expenditure towards investment remain marginal because there is not much economizing on revenue expenditure, there are some tax concessions, and the fiscal deficit target is maintained (Table 1).

Pending the report of an expenditure management commission on rationalization of subsidies they have actually increased (Table 1) because of a rise in fertilizer subsidy. The total is restricted to 2 per cent of GDP but they still appear to be underfunded. To overachieve the BE fiscal deficit target the interim budget rolled over some expenditures, forced PSUs to pay large dividends, and sharply cut capital expenditures. Even the markets would be happier with a less ambitious target short-run that removed the need for such stratagems.

The commitment to long-run fiscal consolidation, however, is very much a positive, especially in the Indian context where we are just recovering from extreme external fragility induced by government overspending. But sticking to the letter of the short-run may lose an opportunity to improve the composition. Quality and sincerity of fiscal consolidation matters more. Supply-side factors largely drive inflation but we have among the highest rates of youth unemployment in the world, and need to act vigorously, just as many Western countries are doing, to kick start growth.

In effect there is a gamble on growth. But it is better founded now because of revival of domestic optimism and of international growth. Oil prices have softened, and a stronger rupee and automatic rise in diesel prices will reduce the subsidy. More resources can also be raised from divestment because of a booming domestic stock market. Optimistic revenue receipt projections of the interim budget are retained, but they are feasible since they are slightly lower at 15.6 than the 17.1 2013-14 RE increase over actual values in 2012-13 (Table 1). The odds for such a gamble are more favourable, but there is a risk of old unproductive strategies such as a cut in investment to meet targets hurting growth and raising inflation.

The second issue is to limit transfers to capacity. Re-designing transfers so they build capacity would achieve this, even as they increase equality of opportunity. A stable government, at the beginning of its term, has more freedom to act quickly towards shifting from populism towards productivity. A reluctance to risk a departure from the status-quo would be a dangerous misreading of the election mandate.

Active Inclusion

Voters want good public services such as infrastructure, water, sanitation, health, and education, which facilitate work. According to scholars of political systems (Acemoglu and Robinson, 2012), ensuring broad availability of such services is the way democracy creates prosperity. Indian heterogeneity and vote banks provided a detour that has now run its course.

TABLE 2: Central Plan and sectoral allocations (per cent increase)

	Restructuring	Promises: BJP	Promises: UPAII	Feasibility
	BE over past BE: BJP over UPAII	**BE increase over past RE**		**Past RE increase over 2012-13 actuals**
	1	2	3	4
Central plan outlay	4.22	-21.10	-24.29	23.20
External budget	-0.09	-3.76	-3.67	32.98
Budget support	9.15	-33.63	-39.20	16.98
Sectors				
Agriculture	15.46	-34.32	-43.12	3.09
Rural development	6.20	-93.91	-94.27	13.94
Irrigation	24.45	287.28	211.21	5.69
Energy	1.74	-6.99	-8.58	35.29
Industry and minerals	4.16	11.18	6.74	8.93
Transport	4.66	6.58	1.84	20.45
Communications	-0.08	39.39	39.50	48.40
Science technology and environment	7.88	38.43	28.32	12.67
Ministries				
Social service	5.73	-51.69	-54.31	20.49
Human resource development	5.33	-71.43	-72.88	11.40
Health	9.06	-67.58	-70.27	11.71
Drinking water and sanitation	0.00	-98.08	-98.08	-7.43
Health and family welfare	9.06	-67.58	-70.27	11.71
Housing and urban poverty alleviation	0.00	77.63	77.63	33.29
Human resource development	5.33	-71.43	-72.88	11.40
Department of school education and literacy	7.02	-93.70	-94.11	10.13
Department of higher Education	5.00	-0.02	-4.78	15.67
Labour and employment	22.87	-53.22	-61.93	-0.23
Water resources	85.43	363.57	150.00	36.45
Women and child development	11.25	-94.57	-95.12	7.36

Source: Calculated with Budget data available at indiabudget.nic.in

The 'virtual' middle class has exploded as social media raised awareness. Rural peri-urban migration has created a large neo middle class, and the country's demographic profile has increased the share of youth. All these sections gain more from a good working environment as compared to doles. Even the lower income classes stand to gain as a richer set of jobs become available.

As compared to the earlier mantra of inclusive growth the new mantra should be 'active inclusion' through increasing productivity and jobs (Goyal, 2014), with direct transfers conditional on nutrition and education (or effective schemes) only for the persistent poor. In addition, good sanitation and water raise productivity yet are the most effective anti- poverty and pro-nutrition schemes.

There is a push towards infrastructure, housing, water—key constraints alleviation of which would make life much easier for the average citizen. Table 2 Columns 1 and 2 show a large increase in spending for housing and irrigation.

Sectors

Goyal (2012) argued a solution to economizing expenditure yet increasing growth is to restructure government schemes so they add to a broad definition of capacity including human capacity. Second, careful targeting of expenditures to alleviate bottlenecks to growth and employment, giving the biggest impact for each rupee spent. This requires re-allocation of sectoral expenditure.

There are signs of allocations going up relatively in infrastructure sectors and down in social sectors and ministries (Table 2). But the UPA II (Column 3) seems to have started this, with the BJP merely following, but planning to spend significantly more on water resources. Perhaps the UPAII had realized its allocations had strained the economy, or these sectors were the easiest to cut, or capacity to spend was lacking in those ministries. But Column 4 shows the ministries had spent larger amounts earlier, so the reason was probably to re-allocate expenditure. Spending for the social sector is also essential, but even here it is possible to focus on capacity creating expenditures.

There is a bureaucratic legacy that makes it difficult to quickly bring about detailed changes. But the BJP government is actually increasing allocations for the social sector over those of the UPAII in the Central Plan itself and through higher growth in grants for capital formation that comes under revenue expenditure (Table 1), and raising allocations for labour intensive industrial sectors such as textiles, tourism and construction.

Implementation will also be crucial for outcomes, and that is supposed to be a forte of the new government. But it cannot be taken for granted. An index (updated from Goyal 2010), based on the coefficient of variation in the realization of planned central plan allocations, used to rank post-reform governments, showed the Congress had the least deviation from plans (-0.6), followed by UPA 1 (-3). NDA was only third (-7.1), although UPAII did much worse (-9.97). Effort will be required to break from the past, and deliver on promises.

Improving systemic incentives

Faster decision making requires systems that enable this. Obsolete administrative structures lead to delays. This became clear in 2009, when the share of non-performing bank loans rose as infrastructure projects were delayed. The latter predated the big corruption scandals starting with the CAG report and common wealth games that blew up in 2010. So, while corruption and the fear of CBI enquiries do create delays they are not the major cause of government paralysis. But this issue is not addressed in the budget.

Although the number of minsters has reduced in the BJP government compared to UPA, budget allocations are still made for 49 ministries compared to 50 for the UPA. There is no serious attempt to synergize across schemes and ministries to saving costs. Instead many new schemes have been announced, with small initial seed capital. The finance minister is, however, using the inability of government to spend effectively to ration initial allocations. It improves incentives if more is given to those who are able to use it well. But supporting institutional changes are required to ensure implementation. New technologies are to be leveraged to improve governance.

Perverse incentives hurt the quality of Indian public services. For example, more than just the amount of subsidies, it is the way they are given that creates problems—subsidies tend to be price and allocation distorting. Minimum Support Price (MSP) and subsidies focused on food grains prevent production from aligning to demand that is changing towards vegetables and proteins. Fuel oil subsidies prevent energy saving substitution; cross subsidization in fuels such as diesel and kerosene create pollution and corruption, imposing serious long-term social costs, such as a rising incidence of cancer in the Punjab. Rationalization of subsidies requires increasing use of direct income transfers.

There are initiatives to reduce high transaction costs and the possibility of unproductive arbitrage, especially in the areas of tax structure and administration. There is a commitment to transparency, simplification, to listen to and rectify complaints. There are legal and administrative changes to reduce tax litigation, uncertainty, discretion and ease access; resident tax payers can also get an advance tax ruling; a high level committee will be set up to regularly interact with industry and respond to issues raised. Mutual fund earnings are subject to capital gains not income tax, removing incentives for arbitrage in fund location, and across funds.

The major increase in tax revenue has come from increasing the tax base for services, in line with the expected change to GST. A low rates and large base philosophy suits India's large population size, and meets criteria of fairness, although the growing class of Indian billionaires can afford to contribute more for the country's development. The continuing temporary surcharge on the wealthy could be shifted to a higher threshold and made permanent. Technology, information in the TIN database, and applying a consistent consumption tax through the GST, can all help expand India's low tax base. Only 3 per cent of Indians pay taxes compared to 20 per cent in China. So the potential for expansion is enormous. The budget takes only a very small step in this direction.

Conclusion

Although overall tactics are aligned to the strategy, the alignment is only marginal as yet, because the various strands are not well integrated to tell a coherent story of how they work together, and changes are not quantitatively significant. This is unfortunate because the measures for raising different types of investment, and improving their financing will reinforce each other to raise growth and jobs. As will the focus on employment intensive sectors, infrastructure, housing, agricultural marketing and crop movement. There are also small beginnings in better systems, incentives, composition of public spending and public services. Apart from contributing to growth these help improve equality through capacity creation so the economy does not hit bottlenecks. A composition of government expenditure weighted towards consumption had raised inflation in the past.

But the budget speech does not clearly communicate such a story, preferring to hedge its bets through maintaining continuity with the old, throwing in something for everyone.   A failure to articulate can also imply a failure to understand. This is dangerous because politics as usual can fritter away a real opportunity for change. A conscious process is always better implemented.

References

Acemoglu, D. and J. Robinson. 2012. *Why Nations Fail: The Origins of Power, Prosperity and Poverty*. New York: Crown.

Goyal, A. 2014. 'Introduction and overview'. In *Handbook of Indian Economy in the 21st Century: Understanding the Inherent Dynamism,* Ashima Goyal (ed.), New Delhi: India.

Goyal, A. 2012. 'An Appraisal of Five Year Plans and the Future'. In *Yojana, special issue on 'An Approach to 12th Five Year Plan– Issues and Challenges'*. January.

Goyal, A. 2010. 'Assessing the Fiscal Capacity of Indian Governments'. *Economic and Political Weekly*. XLV(13), pp 46-55. March.