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India's Interim Budget: Credit and Concerns

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In India, a vote on account is normally considered to be an interim accounting measure that permits government departments to continue to function at the same level as at the time of the vote, without the introduction of new programmes or projects. The latter would require debate and approval of the parliament in a full debate. In India, with the general election hardly a couple of months away now, the vote on account is merely a roll-over of sanctions for expenditure for the first four months of the new year beginning April 2014 – until a new parliament and government are in place. At the same time, the vote on account gives a peep into the state of public finances, and in a way, indicates the opening balances of accounts for the next government. This year's exercise, placed before the Indian Parliament on 17 February 2014, was no different.

The Finance Minister took credit for adhering to fiscal deficit target, announcing that it would be lower than the budgeted figure of 4.8% of GDP. The Current Account deficit, another

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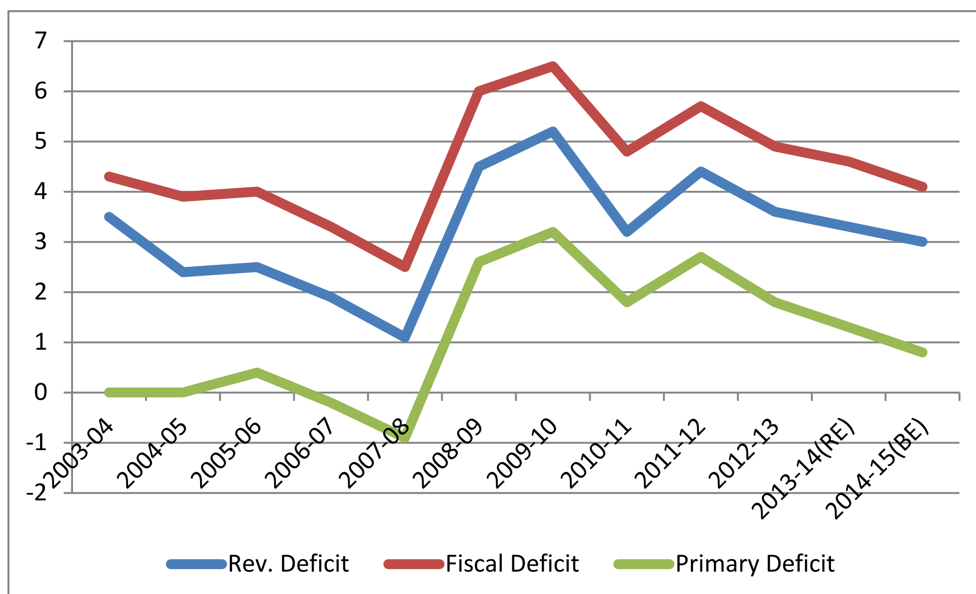
measure that was worrying the nation, would be around US$ 45 billion, against the US$ 80 billion anticipated earlier. The reduction has been achieved primarily through curtailing of gold imports. There was also some satisfaction over the recent trends indicating that the Consumer Price Index increases have been contained at around 6% on a month-to-month basis. As a statement of achievements, the Finance Minister should be content that the balance sheet that he presented is close to what he promised, when he announced the budget last year. Certainly there should be credit given for focusing on fiscal consolidation as well as on the worries of inflation and current account deficit; and the Finance Minister has done a creditable job in difficult circumstances.

	Rev. Deficit	**Fiscal Deficit**	**Primary Deficit**
2003-04	3.5	4.3	0
2004-05	2.4	3.9	0
2005-06	2.5	4	0.4
2006-07	1.9	3.3	-0.2
2007-08	1.1	2.5	-0.9
2008-09	4.5	6	2.6
2009-10	5.2	6.5	3.2
2010-11	3.2	4.8	1.8
2011-12	4.4	5.7	2.7
2012-13	3.6	4.9	1.8
2013-14(RE)	3.3	4.6	1.3
2014-15(BE)	3	4.1	0.8



(All figures are in percentages of GDP)

There are however, some points of concern for the next government in these numbers. First, gross tax revenues are barely above 10% of GDP, much lower than the 12% achieved in 2007-08. As the economy grows, shares of revenue in GDP are normally expected to grow. It is difficult to accept the expectation in the Finance Minister's figures that tax revenues would grow by 18% in the next year, having fallen short of expectations this year. The fiscal consolidation has not come from better revenues, but from tighter control over expenditure. There has been significant compression in expenditure, in capital as well as revenue – in effect, subsidy payments close to Rs 25,000 crores are due, and would be a burden on the next budget. The budget for the next year presented by the Finance Minister shows a sharp compression in Plan expenditure – Health expenditure down from Rs 25,990 crores in 2013-14 to Rs 7,726 crores in 2014-15; Rural Development (a flagship department) allocations down from Rs 61,810 crores this year to Rs 7614 crores next year. There has been a significant increase in transfer of funds to states – from Rs 5,25,677 crores this year to Rs 7,79,485 crores in the next year. There have been media comments that this is intended to cause the next budget-maker some embarrassment. (All figures in this narrative are in line with India's accounting terminology in regard to amounts expressed in terms of Indian currency.)

The fiscal consolidation, according to several commentators, has been more cosmetic rather than real. The International Monetary Fund (IMF) report, that came out in February 2014,

after this budget, questions a number of the assumptions in the report.[2] The Government has been reporting that the slowdown of growth is due to external factors. But the IMF report attributes "two-thirds" of the slowdown to internal factors, which include high inflation, lack of decision making in government and institutional constraints in programme delivery. The IMF is concerned with the stress levels in banking caused by high level of non-performing assets. The IMF supports the need for inflation controls, and recommends increases in policy rates by the Reserve Bank of India going forward. The following are the major recommendations of the report:

> -High and persistent inflation is a key macroeconomic challenge facing India. Further increases in the policy rate will be necessary to tackle high inflation and inflation expectations.
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> -If external pressures from global financial market volatility resume, rupee flexibility should be the first line of defence, complemented by use of reserves, increases in short-term interest rates, actions on the fiscal front, and further easing of constraints on capital inflows.
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> -Further fiscal consolidation is needed. Tax and subsidy reforms will be required to durably lower fiscal imbalances.
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> -Enhanced financial sector supervision, better monitoring of banks' credit quality, and improved information on corporate vulnerabilities will be needed as a basis for tackling rising corporate and financial sector strains.
>
> -Addressing supply bottlenecks and structural challenges – particularly in the agriculture and power sectors and in the pricing and allocation of natural resources (including coal, natural gas, and fertilizers) – will be essential to achieve faster growth, job creation and poverty reduction.

[2] IMF country report 14/57 February 2014

There is obviously concern that India's macroeconomic policy is not on the right track. In the context of high inflation, fiscal stress, and supply-side constraints that put pressure on the CAD, there is a lot for the next government to do to set things in order.

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