THE ECONOMIC TIMES

POINTS OF VIEW

Budget 2012: Not enough action on fiscal correction

Mar 17, 2012, 06.41AM IST

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It's a typical Pranab Mukherjee workman like budget: dependable, pragmatic, no frills, not path breaking, and at the same time without major errors or bad policy initiatives .What are the current key economic problems that we could have expected the budget to address?

A significant fall in overall growth relative to expectations, particularly in manufacturing; inflation which has been among the highest among the world's large economies; fiscal imbalance (the increase in revenue deficit offering further evidence of the deterioration in quality of expenditure, particularly with the increase in subsidies); a decline in gross domestic savings, led by 4 percentage point of GDP fall in public savings, leading to lower investment and growth; and a wider trade deficit, pushing the current account deficit up to about 3.6% of GDP, the highest we have ever had. How many of these issues does the budget address?

Fiscal slippage is related to each of these problems. As documented by the Economic Survey, quoting the IMF Fiscal Monitor, the average fiscal deficit of the advanced economies was 6.6% of GDP in 2011, and that of emerging market economies 2.6%. For a country far removed from the crisis of the North Atlantic countries, our level of combined central and state fiscal deficit at 8-9 % of GDP is way too high.

With the projected central fiscal deficit of 5.1% for 2012-13, this would at best come down to 7-8 % of GDP. The FM has indeed done well to unify and increase the excise and service tax levels to 12% despite considerable ill-advised pressure to the contrary from private industry lobbies.

This measure will provide most of the increase in tax revenue that has been projected. He has also indicated that he expects to make progress on both the GST and DTC; and that he will bring back the FRBM. Welcome as these are, not enough has been done. In fact, after the concessions, income-tax loses rather than gains revenues. Given the ostentatious expenditure observed, a great deal needs to be done to bring more people into the tax net.

Unfortunately, the budget has no measures to this end, administrative or otherwise. In expenditure, the key slippage is in subsidies . The FM has expressed the intention of limiting total subsidies to 2% of GDP going down to 1.75% in three years, while providing fully for food subsidy.

Whereas this is an impressive sounding objective, we may note that the total subsidy, earlier estimated at 1.6 % in BE 2011-12 (2.45% RE), was in fact much lower. So even if this objective will indeed be met, it doesn't imply any reductions in subsidies relative to the past. Moreover, no indication is given on how the non-food subsidy will be controlled.

He could have taken advantage of the new Census information that far more people have cell phones than LPG cylinders to take much bolder steps, particularly given the rising global oil prices. Only if revenue expenditure is curtailed will the revenue deficit come down, raising public sector savings and lowering government borrowings and, alongside, interest rates. Only then can private corporate investments go up, restoring the 8-10 % growth rate we aspire for.

My main concern with this budget is that it doesn't give us adequate signalling for the kind of growth-inducing fiscal consolidation we need. Perhaps, the current political economy conditions do not allow for stronger action and he has done the best he can.

The FM also announced some measures for further development of the financial sector, including establishing the Public Debt Management office. Given the current fiscal scenario, this is clearly the wrong time to make this change from the very competent debt management that the RBI has done for the country over the last 75 years. In the interest of financial and fiscal stability, the government would be well advised to shelve this ill-advised change in debt management.

Manufacturing led the fall in growth in 2011-12 . The budget does little to remedy this. The sharp rise in non-oil, non-gold trade deficit indicates that industry is indeed becoming relatively uncompetitive in both domestic and export markets. This may not be an appropriate subject for the budget, but exchange rate and capital account management policies must change to give Indian industry an even chance to compete.