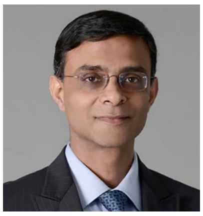
COMMENT

Indian budget a mixed report card for Modi



The Modi government's first budget is a missed opportunity, says DILIP PARAMESWARAN*

THE MODI GOVERNMENT'S first budget for the year 2014–15 failed to seize the possibilities in front of it. India elected Narendra Modi last year largely on the hopes that he would deliver growth and jobs. Based on his track record in Gujarat of running an efficient, corruption-free government, everyone hoped that he would quickly deliver the reforms needed to power up India's growth rate and deliver jobs to realise the demographic dividend and avert a demographic disaster.

Instead of concrete steps, backed up by real money, to address the problems that shackle India, the latest budget contains yet more plans and dreams of future action.

The budget has to be judged in two contexts. One is the historic opportunity facing the country, and the other is the urgent need for reform.

India faces a fortuitous situation of falling oil and commodity prices. Since India is a large importer of oil, the falling oil price would benefit it in many ways: it would contain the current account deficit, lower the fiscal deficit and temper inflation. In many ways, this frees up resources that can be invested in infrastructure and education to take the country to a higher level of sustainable growth.

But the government has not taken full advantage of this opportunity. Other than fuel, the budget has actually raised the subsidies for food and fertilizer. It even increased the allocation for the rural employment guarantee programme started by the previous government. Without cutting these expensive subsidies, the country is going to find it difficult to generate resources for investment. This failure to curb the subsidies is one of the most significant shortcomings of the budget.

The budget does plan to provide more funds for developmental expenditure – roads, railways and infrastructure – but only by assuming high GDP growth and tax collections. It assumes nominal GDP growth of 11.5%, which could translate to a real growth rate of 8% to 8.5%. Although the recent revision to the GDP growth calculation has pushed up reported growth to 7.4% in the last quarter, it remains doubtful whether growth can rise enough to match the budget's assumptions. After all, everyone was forecasting a rate of about 6.5% not long ago. The expected tax revenue growth of 15.8% also looks problematic, coming after a more modest 9.9% for the last year. If the tax collection ultimately falls short, the government will find it difficult to fund all its promises and still restrict the fiscal deficit to the planned 3.9%.

TO ITS CREDIT, the budget contains several good ideas for the future. The planned reduction in corporate tax rate from 30% to 25%, while eliminating many of the tax exemptions, is a step in the right direction, but it will be done over four years. After several years of planning and discussion, the implementation of the national goods and services tax is targeted for April 2016, provided that legislation is agreed. The government has also announced plans to turn the gold holdings of Indians into monetary savings. It aims to improve the ease of doing business and reach a ranking within the top 50 from the current 142. It is considering establishing "plug and play" infrastructure projects with all regulatory clearances and coal/gas links in place. It is planning a new bankruptcy law to deal with non-performing bank assets.

Another positive step announced in the budget is the agreement with the Reserve Bank of India to target inflation of 4% within a band of 2% to 6%. This is likely to bolster the independence of the central bank in setting monetary policy. Once the required legislation is passed, the government intends to set up a monetary policy committee rather than leave decisions to the central bank governor, although the danger is that the committee would be seriously compromised if it is stuffed with political appointees.

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THE ISSUE IS that these ideas are all promises for the future. In the meantime, the government has failed to reallocate hard money from wasteful expenditure and subsidies to development. It is not clear if the government will have the luxury of low oil and commodity prices for the next few years. If oil prices start rising, India's finances will again be squeezed, and these plans may never make it to reality.

The government has also postponed the target of bringing the fiscal deficit within 3% by one year – it now expects to achieve it by 2017–18. While a lower fiscal deficit need not be India's sole focus, the achievement of that target also depends on oil prices remaining benign.

It is not easy to turn around a large democracy like India, and the Modi government deserves praise for thinking through some important ideas for the future. But it could have been so much bolder in reallocating resources from wasteful expenses to productive uses. After all, opportunity knocks but once.

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