The Budget and BJP's Economic Policy*

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Budget 2014-15 is the first indicator of what the broad contours of the BJP-led NDA government's economic programme is likely to be. Having been relatively silent during the election campaign on the specific economic trajectory and set of policies it would adopt if it came to power, the BJP in government has to reveal where it stands. This gives this year's budget speech and numbers a special significance.

To recall, the BJP had made "development" its principal electoral platform. Together with a declared allegiance to an undefined "Gujarat model", this was read as a promise not merely to revive and accelerate economic growth, but to wave a magic wand that would get rid of inflation, unemployment, poverty and much else. Few believed this to be wholly true. But the NDA's propaganda machine had managed to convince a chunk of the electorate that something different was possible if the BJP came to power.

But even those who believed this to be a possibility had no clear idea of what the BJP's economic programme was. When in the opposition, the party had tight-rope walked between opposing much of what the Congress proposed, and preserving its image, cultivated during its previous stint at the Centre and under Narendra Modi in Gujarat, that it was as or more pro-business and "reformist" than the Congress. Once in power, the emphasis has been on sending out clear signals that the BJP is pro-reform, against 'wasteful' subsidies, for fiscal consolidation and foreign investor friendly. Talk has shifted to having to take tough decisions given the state of the government's accounts, and railway passenger fares and freight rates were hiked by just before the Railway Budget. Finally, the Economic Survey has argued that controlling inflation is crucial to growth, and fiscal prudence is needed to rein in prices. It is in that background that Budget 2014-15 must be read.

If there is a defining, central feature of that budget, it seems to be that of diminishing the role of government expenditure and, therefore, of the budget. Euphemistically described and justified as marking a shift to "minimum government" with "maximum governance", this tendency seems to be the result of an even greater commitment to fiscal conservatism than characterised the previous UPA governments. Thus, though Finance Minister Arun Jaitley began his budget speech by declaring that "the people of India have decisively voted for a change," he seems to be intensifying the fiscal contraction begun under the UPA, leaving little room to undertake the expenditures that can ensure the change. In fact, the new Finance Minister declares that he is going to take up the daunting challenge that his predecessor set in the interim budget, and stick to the decision to bring down the fiscal deficit from 4.5 per cent of GDP in the last financial year to 4.1 per cent this year. This according to him is the kind of "fiscal prudence that will lead to fiscal consolidation and discipline.

If the reduction in the fiscal deficit is to be achieved without substantial additional resource mobilisation through new taxes, expenditure would have to be squeezed with adverse implications for growth and welfare schemes. It was possibly to conceal this that Arun Jaitley imitated his predecessors and included a long and tiresome Part A in his budget speech. Much time was wasted on "announcing" a host of minor measures, many of which are not really within the scope of an annual budget, some of which amount to the mere restructuring and renaming of pre-existing schemes, and some others are meaningless given the small allocations of Rs. 100 crore or less to schemes and projects that require much more to matter. The minister was stretching himself to claim that the new government has a lot of new schemes to offer. Nobody was really convinced.

The imitation of this dilatory mode of presentation from the past was clearly one of two ways adopted to divert attention from the essentially deflationary character of the budget. The other was to dole out sops to a small section of the middle class—identified as the "neo-middle class"—in the form of an increase in minimum income that would be subject to taxation and of enhanced exemptions of income diverted to savings and investment. Those concessions seem partly aimed at blunting criticism that the budget does not live up to the expectations of change the Bharatiya Janata Party-led, National Democratic Alliance had promised when it made a successful bid for power in the recently held parliamentary elections. Individual benefits are small, but the aggregate cost is not insignificant. The Finance Minister himself estimates the revenue loss arising from these and other direct tax concessions at Rs. 22,200 crore. His effort to partly recoup that loss by tinkering with indirect taxes yields only Rs. Rs. 7,525 crore, implying a net revenue loss of Rs. 147.76 billion.

Given this willingness to forego revenues in order to sanitise fiscal contraction, how is the Finance Minister expecting to ensure "fiscal consolidation". One device adopted is to window dress the numbers. By assuming high tax buoyancy, the Finance Minister expects to increase gross tax revenues by more than Rs. 220,000 crore in 2014-15 as compared with around Rs. 122,700 crore in 2013-14, despite the tax concessions mentioned earlier.

These optimistic revenue projections in themselves, however, prove inadequate to meet the 4.1 per cent fiscal deficit target. In the words of the Finance Minister, he has "limited fiscal space." To achieve fiscal consolidation, therefore, he has had trim to expenditures considerably. As compared with a Rs. 156,000 crore increase in revenue expenditures during 2013-14, Budget 2014-15 provides for a smaller Rs. 150,514 crore increase. This is combined with lower capital expenditure increases of Rs. 22,266 crore in 2014-15 (as compared with Rs. 24,036 crore in 2013-14), to ensure that aggregate budgetary expenditure rises by just 11 per cent in nominal terms in 2014-15, as compared with 13 per cent in 2013-14. Since the current rate of consumer price inflation is well above 8 per cent per annum that amounts to a marginal increase in real total expenditure adjusted for inflation. In sum, a combination of unrealisable tax buoyancy and an ambitious expenditure control programme are to deliver the fiscal consolidation that Jaitley commits himself to.

One obvious consequence of this fiscal stance would be that government expenditure would do little for growth. Jaitley seems to have forgotten that India's smart recovery from the crisis-induced slowdown in 2008-09 was the result of a fiscal stimulus. The deceleration in growth experienced over the last three years is unlikely to be reversed, despite the Minister's stated desire to embark on "a journey to sustained 7-8 per cent growth.

The second consequence of the fiscal stance would be that to even sustain this low level trajectory the government would have to generate resources through means other than taxation. As signalled by the hike in railway fares and freight prior to the presentation of the railway budget, and the decisions to automatically hike future fares in tandem with fuel costs, link domestic fuel prices to international prices, and to trim "populist" subsidies, the government intends over time to get the public sector to raise prices and hike user charges so as to reduce budgetary dependence and self-finance a higher share of its capital expenditures. That, however, would raise costs and aggravate cost-push inflation. It is not just growth that would be the casualty of the budgetary stance being adopted by the government, but the economy would remain mired in the stagflation afflicting it for some time now.

Third, the government would opt for reducing or holding back on social spending, eroding even the small advances made in these areas. Despite the inadequate spread and the employment shortfalls that still characterise the national rural employment guarantee programme, the aggregate allocation for the Mahatma Gandhi National Rural Employment Guarantee Act (MGNREGA), is placed only at around Rs. 33,353 crore, or just Rs. 350 crore more than the revised estimate for 2013-14. The allocation for food subsidies of Rs. 115,000 crore for 2014-15 seems an improvement when compared with the, higher than Rs.92,000 crore spent in 2013-14. But that increase is likely to prove inadequate to implement the promise held out by the Food Security Act. Overall, even if the estimates put out in the budget are realised, the fiscal stance erodes even the small commitment to welfare made through legislation in recent years, by squeezing allocation. Actual allocations are likely to be even smaller.

All this does not mean that the government has no strategy whatsoever. Rather behind the effort to shrink government in order to achieve "fiscal consolidation", is a scheme to look to the domestic and foreign private sector to raise investment and revive growth. From a policy point of view, therefore, the emphasis is on incentivising and facilitating private investment. Besides private investment in much needed infrastructure, the declared strategy seems to be one of making India a hub for labour intensive manufacturing with appropriate private investments, which too would involve considerable reform, including reform of labour laws.

This is a major thread running through the budget, though actual measures to experiment with such options are few. For example, higher caps on foreign equity investment in crucial sectors (like insurance and defence production, where it has been raised from 26 to 49 per cent in the current budget) and better terms for foreign investors is being seen as a means of attracting foreign investment into infrastructural sectors. This is to be combined with faster clearances for land acquisition and less onerous environmental impact assessments to push stalled infrastructural projects. The import duty structure has also been tinkered in the name of facilitating domestic value addition through integration into global value chains. The commercial real estate business has been favoured by encouraging Real Estate Investment Trusts that would now be given the benefit of pass through in taxation. And various allowances and concessions, including an expanded investment allowance scheme, have been offered to industry in the hope that it would respond with investment. But with the world economy still not out of recession and the domestic economy still mired in stagnation, the demand that would encourage the private sector to increase investments is missing, and the budget worsens that constraint despite its pro-business flavour.

The NDA's reformist image has also been backed with an ambitious programme of disinvestment of public assets. Disinvestment receipts, which amounted to Rs.25,890 crore in 2012-13 and were budgeted at Rs.54,000 crore in 2013-14 (but actually touched only Rs. 19,027 crore), are projected to rise to Rs.63,425 crore in 2014-15. Of this Rs. 15,000 crore is to be mobilised from sale of the government's stake in non-government companies. However, dumping large volumes of shares in the market to realise these targets are bound to depress stock prices and limit this option in practice.

Thus, despite its single-minded focus on private sector-led growth, the budget is unlikely to deliver on the growth objective. Further, as noted earlier, there is little done to address inflation in the budget either. Nor is there any effort to address the problems of India's poorest. Perhaps, recognising this Finance Minister Jaitley cautioned his listeners by saying "it would not be wise to expect everything that can be done or must done to be in the first budget presented within forty five days of the formation of this government".

But having generated great expectations during the election campaign that brought this government to power, the people may not be willing to wait for long. So the the hype and propaganda that marked the election campaign continues. Prime Minister Modi, whose backing for Jaitley and his budget is evident, declared in a twitter post: "The Budget is in line with our vision for a skilled & digital India, guided by Mantra of 'Sabka Saath, Sabka Vikas'." Hopefully, he will explain why he thinks so, because it is by no means clear, let alone obvious.

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