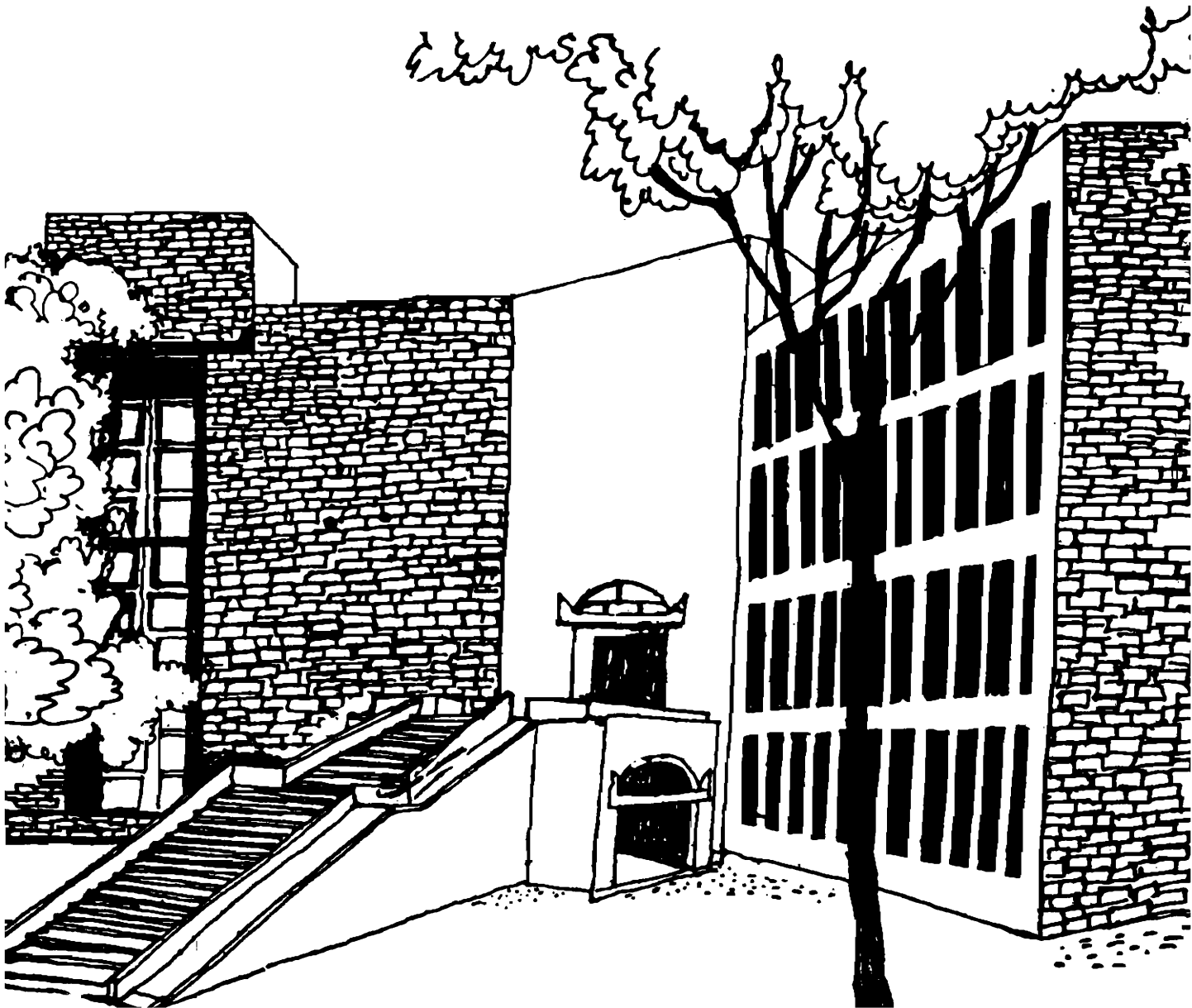




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MACROECONOMIC ANALYSIS OF
UNION BUDGET 1995-96

By

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Abstract

Union Budget for 1995-96 was the fifth consecutive budget presented by Dr. Manmohan Singh, the main architect of India's recent economic policy reforms. Formulation of this budget was, however, a more difficult task than the earlier ones for various reasons. An attempt has been made in this paper to present a broad macroeconomic analysis of the main proposals and provisions of the Union Budget 1995-96 in the context of the stated objectives of the budget and examine the likely impact of the budget proposals on the economy especially in the short run.

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1. Introduction

Union Budget for 1995-96 was the fifth consecutive budget presented by Dr. Manmohan Singh, the main architect of India's recent economic policy reforms. Formulation of this budget was, however, a more difficult task than the earlier ones for various reasons. Sharp deterioration in the fiscal situation during the last two years, recurrence of high inflation rates after mid-1993, growing criticism of economic reforms especially after the massive reverses suffered by the ruling party in the state elections during 1994-95, substantial unfinished agenda for further economic reforms required to be introduced in near future and the serious & urgent political compulsions of the ensuing general elections due latest by mid-1996, were some of the factors that the Finance Minister had to reckon with. These factors created an unprecedented and highly confusing situation of conflicting pulls and pressures that any professionally oriented finance minister would always like to avoid. Thus, Dr. Manmohan Singh was placed in a situation where he had to make hard choices involving popular politics versus sound economics. However, what turned out to be equally unfortunate was that Dr. Manmohan Singh, as some might have perhaps expected, actually ended up pursuing a directionless middle path indicating more inaction than action on several crucial fronts, which disappointed many including industrialists as well as professional economists.

It would be interesting to carry out a broad macroeconomic analysis of the budget proposals and their likely impact on the economy especially in the short run, i.e., during 1995-96. With this purpose in view, the present paper makes an attempt to analyse the main proposals and provisions of the Union Budget 1995-96 in the context of the stated objectives of the budget.

2. Objectives of the Budget

The main objectives of the Budget for 1995-96, as indicated in Part-A of the Finance Minister's Budget Speech and explicitly stated during the conventional post-budget briefing, are as follows :

1. To strengthen anti-poverty programmes;
2. To control inflation and bring it down to below 10%; and
3. To accelerate growth & investment and encourage modernisation of industry.

While renewed thrust on poverty alleviation was widely expected in this budget, there are some striking omissions from the basic set of objectives of this budget which deserve special mention. Thus, for instance, the basic objectives of the budget do not specifically include crucial issues such as strengthening the focus on export orientation

and accelerating the process of economic reforms, especially the financial sector and the public sector reforms. In what follows, we examine various proposals and provisions of the budget in detail from the point of view of how each one of them relates to the given objectives and to what extent they can be expected to succeed in fulfilling these objectives. The main proposals and provisions of the budget are summarised in *Exhibit 1*, while a summary of the budget estimates of aggregate revenue, expenditure and deficit is given in *Exhibit 2*. Details regarding various components of revenue receipts and expenditure are given in *Exhibits 3 & 4*.

3. Anti-Poverty Measures

Five specific measures directly addressing the issue of poverty alleviation have been proposed in this budget. Our assessment of each of these measures is as follows:

- (a) A new Rural Development Infrastructure Fund is proposed to be created within NABARD with an estimated corpus of Rs.2,000 crores to encourage and facilitate quick completion of ongoing rural infrastructure projects (mainly small and medium irrigation projects) in various states. However, the financial burden of this scheme will be borne by the banking system and not by the Central Government. This is a truly innovative idea because, while it lays emphasis on speedy completion of rural infrastructure projects which could yield quick results in the short run, it does not cost anything to the exchequer as it is entirely financed out of extra budgetary resources. The Finance Minister has indicated that the resources for this fund will come from the commercial banks with each bank being required to contribute an amount equivalent to the given bank's short fall in achieving the priority sector targets for agricultural lending. A significant aspect of managing this fund is that the loans out of this fund will be on a project-specific basis with payment of interest as well as repayment of principal amount being guaranteed by the concerned state government. This aspect seems to have been so carefully incorporated in the proposed scheme, mainly because rural lending of this nature is known to suffer from the problem of inadequate debt servicing and this can seriously affect the reported profitability of commercial banks, especially under the new provisioning clauses recently introduced for assessing and reporting banks' true profitability. Thus, this innovative idea tries to simultaneously fulfil the seemingly irreconcilable objectives of making a sizeable investment aimed at producing demonstrable quick results within a short period of 12-15 months without in effect creating any additional financial burden on the already scarce resources of the Central Government, and at the same time, also protect the interests of the commercial banks, at least on paper, through appropriate state guarantees. However, ironically it is precisely this aspect that creates serious doubts about the timely formulation and implementation of this scheme. It would be a Herculean task to deal with several state governments which are known to be lethargic in project implementation and ensure that they would not only cooperate in a speedy case by case evaluation of project-specific loans but also show the willingness to provide the necessary guarantees and effectively abide by them later. Moreover, it is also inevitable that the task of identifying specific projects to

be covered under this scheme would itself take a long time, especially since the precise responsibility for this task has not been clearly entrusted to a specified agency out of the three main agencies involved, viz., NABARD, the concerned commercial bank and the concerned state government.

- (b) Another measure of a similar nature is the proposal to revamp Khadi industries, which constitute the backbone of India's rural economy, with the help of a new scheme providing Rs.1,000 crores to Khadi and Village Industries Commission (KVIC). Under this scheme, KVIC will lend to viable cottage industries, which of course will have to be identified first. Again, the banking system is expected to play a major role in the success of this scheme and this scheme also involves the same problem of eliciting the necessary guarantees from the concerned state governments. It is obvious that in the absence of effective guarantees, the viability of commercial banks will suffer if such hastily conceived lending programmes are implemented on such a large scale within a short span of time.
- (c) It is proposed to set up a special Technology and Modernisation Fund under Small Industries Development Bank of India (SIDBI) with a corpus of Rs.200 crores to build & strengthen export capacity of small scale industries. The financial assistance under this scheme would be directly provided by SIDBI to eligible small units and it could take the form of either loans or equity. It is proposed that the scheme will be jointly funded by the Central Government and SIDBI on a 50:50 basis. It should be noted here that this scheme essentially represents an extension of an earlier scheme of a National Equity Fund introduced in 1987 to provide equity assistance to small scale units with projects of less than Rs.10 lakhs and located in places with a population not exceeding 5 lakhs. Apparently, no information is as yet available on the performance and the impact of the earlier scheme and also the problems encountered in the actual implementation of the scheme. Since the small scale industries employ about 14 million workers, the initial corpus amount provided for this purpose appears to be too small (only Rs.143 per worker) to make any appreciable impact. It has to be recognised that technology upgradation and modernisation of essentially labour intensive industries is a difficult task and it is likely to involve a huge amount of resources, both financial as well as managerial. It is expected that the huge gap between the required resources and the amount that can be made available by SIDBI would be bridged through greater availability of credit from the banking system. For this purpose, the finance ministry has formulated an action plan in consultation with the commercial banks for improving the flow of credit to the small scale sector. The main element of this action plan is the setting up of at least 100 specialised bank branches to serve the needs of small scale units in 85 identified districts, each with more than 2,000 registered small scale units. In this context, an important aspect that deserves careful attention is the growing incidence of industrial sickness among small scale units, especially during the last four years, which has resulted in a significant proportion of commercial banks' loans being classified as non-performing assets, thereby considerably eroding the banks' overall profitability.

- (d) Another special and noteworthy proposal of the budget is the introduction of National Social Assistance Scheme consisting of four specific programmes for the general welfare of the rural poor. The four components of this scheme are: (a) Providing for minimum old age pension of Rs.75 per month for people above 65 years of age who are below the poverty line; (b) A special scheme to provide lump sum survival benefits to poor households, on the death of the primary bread winner (Rs.5,000 per affected family). The survival benefit scheme is proposed to be complemented by a new group life insurance scheme to be introduced by the LIC, which will be implemented by the village panchayats. Under this scheme, life cover of Rs.5,000 is proposed to be provided for a modest annual premium of Rs.70 for poor households, of which 25% would be subsidised by the Central Government with the concerned state government providing an equal amount and the beneficiary contributing the balance amount; (c) The third component of the social assistance package aims at provision of sustenance for pre-natal and post-natal maternity care to women belonging to poor households for the first two births. This scheme is expected to eventually cover about 14 million neediest beneficiaries from the households below the poverty line. Both schemes of survival benefits and maternity care are to be funded jointly by the Centre and the states and they are to be implemented by the states through Panchayati Raj institutions. In fact, a committee will be appointed by the Finance Minister to work out the relevant details of this scheme; and (d) The fourth component of the National Social Assistance Scheme involves release of food stocks from the central pool to expand mid-day meal schemes for school children. Again, the modality of implementation of this scheme will be worked out by a separate committee to ensure that the scheme becomes operational in 1995-96 itself.

It is surprising to observe that no budgetary provision has been made for the likely expenditure on the National Social Assistance Scheme. In fact, during the course of the customary post-budget briefing, the Finance Ministry officials have admitted that the government has made no specific allocation for this purpose in the budget for 1995-96 and that their preliminary estimates indicate that this scheme might cost the exchequer around Rs.1,000 crores per annum and to that extent supplementary demands are inevitable at a later stage, which would correspondingly increase the size of budget deficit as well as fiscal deficit. However, a closer examination of the relevant macroeconomic and demographic indicators clearly shows that the actual expenditure on these four components of the Scheme taken together might significantly exceed Rs.1,000 crores. For instance, we may try to estimate the likely expenditure on the first component of this scheme based on the available official macroeconomic statistics. According to VIII Plan projections, the estimated proportion of population living below the poverty line is likely to decline to around 27% by early nineties. While this appears to be a somewhat ambitious or perhaps wishful projection, even this estimate would imply that the population of poor people above 65 years of age would be around 11.8 million by mid-1995, if we go by the official population projections for 1995 and the demographic profile of the country's population as revealed by the 1991 Population Census. Hence, the basic cost of the first

component (old age pension) of this scheme alone would work out at Rs.1,062 crores per annum and this estimate does not include the delivery cost. If detailed costing is done on similar lines for other components of the National Social Assistance Scheme, the final amount would certainly turn out to be much higher than the provision of Rs.1,000 crores that is eventually sought to be made for this purpose. Moreover, it is interesting to note that in effect the actual beneficiaries of the scheme in each state are yet to be identified and this task itself may take enormous time as well as resources. This creates serious doubts about the effectiveness of this rather ambitious poverty alleviation scheme proposed in the budget.

- (e) The fifth element of the anti-poverty thrust of the budget is a significant increase in the target for provision of housing for the rural poor under Indira Avas Yojna from 4 lakh to 10 lakh houses per year. It is again surprising to find that no indication is available about the likely magnitude of the burden that this scheme would place on the budgetary resources during the year 1995-96. Moreover, there is no indication about the past progress of this scheme and the actual achievement during the last year.

It is evident from the above analysis that the actual budgetary provision for this entire package of anti-poverty programmes is either not made at all or the amount indicated is meager and grossly underestimated. It is difficult to imagine how with such small provisions, large nation-wide schemes like these would effectively deliver the goods. Hence, either the schemes will be ineffective or the actual fiscal burden of these schemes would prove to be disastrous. Only time will tell what actually happens. Moreover, it seems that all these schemes are hastily conceived and the managerial and administrative requirements of each of these schemes have not been explicitly examined. One can predict with reasonable confidence that there would be major formulation and implementation lags in each of these schemes. This would prove to be a serious bottleneck in the actual execution of these schemes, which would in turn seriously jeopardise the prospects of success for these schemes. In our opinion, it would have been more appropriate to initially formulate and implement such schemes on a pilot basis in a few selected districts, which are known to have the highest incidence of poverty. This could have minimised the strain on fiscal resources and, at the same time, given valuable experience and insights to the government on the main bottlenecks and problems involved in the implementation of such schemes. In fact, under the existing conditions, the best anti-poverty programme to be implemented on a country-wide scale would have been to bring the overall rate of inflation down to not more than 5% per annum and generate rapid economic growth that would create income earning opportunities for the poor and the unemployed. However, it is doubtful whether the budget proposals would be able to achieve this highly desirable but ever elusive goal.

4. Measures to Control Inflation

The anti-inflation strategy proposed by the Finance Minister consists of three elements: Reducing excise duties on consumer goods, allowing for easy imports of essential consumer goods and controlling budget deficit & fiscal deficit.

Gross total reliefs in excise duties provided in the budget amount to Rs. 646 crores, which actually represents only 1.4% of total excise burden and to that extent its impact on the overall price level can be expected to be only marginal. Moreover, it is not at all clear whether the benefit of this excise duty reduction will actually accrue to the final consumers. In fact, what proportion of this excise concession would be eventually passed on to the consumers is anybody's guess. However, an important aspect to be noted in this connection is that the railway budget for 1995-96 has already proposed a general freight hike of 7% across the board and this measure is expected to yield additional revenue of Rs.624 crores. Thus, the additional transportation cost resulting from the freight hike would more or less nullify the impact of excise duty concessions. But it is interesting to observe that, while the excise duty concessions are targeted to benefit primarily the middle income group, the additional burden of freight hike would have to be born by everyone. Moreover, since the commodity base for the freight hike is widespread and it covers all items including raw materials, machinery & equipment, etc., it would necessarily have a cascading effect on the cost of production of a large number of industries, which would actually impose a much greater burden on the economy as a whole. As against this, there would be no reverse cascading effect in the case of excise duty concessions because these concessions primarily apply to the items of final consumption goods. Thus, the net inflationary impact of the freight hike and excise concessions taken together is more likely to be positive rather than negative.

As far as the facility to allow imports is concerned, the strategy of ensuring quick, timely and adequate imports of essential items of mass consumption is easier said than done. Doing this through the public distribution route would involve administrative delays and inefficiency, while allowing it through the private trade channel would certainly lead to profiteering in the short-run. Hence, it is difficult to imagine how this threat can effectively work in the year 1995-96 itself. This measure, therefore, appears to be more of a long term solution, because it is only after we have established normal trade channels through experience over time, that this measure can be expected to produce tangible results - provided the scarcities of essential items that we experience at home are only local and not global.

It is obvious from the above analysis that the most crucial aspect of controlling inflation during 1995-96 and thereafter is a much stricter control of fiscal deficit and budget deficit. In this regard, while the Finance Minister has admitted his failure in the recent past, he has now claimed success in making budgetary provisions for the next year which, according to him, would effectively reduce the deficit during 1995-96. In our opinion, this is the most controversial aspect of the budget and it is indeed unfortunate that there is a complete lack of transparency with regard to this important part of the budget. Only the most innocent and perhaps the most indifferent among the people who listened to the Finance Minister on March 15, 1995 would believe that the budget deficit next year could be restricted to Rs.5,000 crores and the fiscal deficit to Rs.57.6 thousand crores, as indicated in the budget speech. If we carefully examine the Finance Ministry's calculations as reflected in the detailed budget documents, we find that revenues from various sources have been overestimated and expenditures on several counts have been seriously underestimated to show artificially low figures of fiscal deficit and budget deficit. Thus, for instance, highly ambitious

and almost wishful projections have been made for the increase in tax receipts as indicated by the following comparison of 1995-96 budget estimates (at existing rates of taxation) with the corresponding budget estimates for 1994-95 for the four major categories of taxes accounting for about 98% of the total tax revenue:

Corporation Tax	24.2%	Income-tax	31.8%
Customs Duties	21.7%	Excise Duties	17.4%

The Finance Minister has tried to justify such phenomenal increases in projected tax receipts for 1995-96 in terms of the buoyancy in tax revenues observed during 1994-95. However, it must be remembered that the high growth of customs and excise during 1994-95 reflects more of a return to normalcy after the steep decline in customs duty collections and near stagnancy in excise duty collections observed in 1993-94 on account of deep recession in the economy. Moreover, it also reflects the twin effects of a sharp acceleration in the growth rate of industrial production (from an average annual rate of only 2% during 1991-94 to more than 8% during 1994-95) and the one-time impact of major tax concessions as well as other incentives given in the previous budget to achieve rapid industrial recovery. Buoyancy in corporate tax collections during 1994-95 was also on account of significant improvement in corporate profitability at least partly resulting from factors like a significant reduction in interest rates and easy access to cheaper global sources of funds. A reversal of such favourable trends could have an exactly opposite effect on corporate profitability in 1995-96. In fact, given the persistently high rates of inflation experienced during the last year, there is a strong possibility of an upward revision of lending rates in the near future; and, if high inflation continues unabated during 1995, there could be more than one upward revision in lending rates before December 1995. Moreover, since no major tax concessions have been given to industry this time and since it is also unlikely that the growth rate of industrial production will further accelerate over and above the growth rate of around 9% that may be achieved this year, it is difficult to envisage further continuation of the same extent of buoyancy in indirect as well as direct tax revenues during 1995-96. It is rather ironical, therefore, that the only possible factor which may contribute to the buoyancy of indirect tax revenue during the next year is the continuation of very high rates of inflation!

It is interesting to note that the projected growth rates of direct and indirect tax revenues underlying the budget calculations imply very high levels of income elasticity of these taxes. Thus, the implicit estimates of the income elasticities underlying the budget estimates for 1995-96 appear to be 1.9 for direct taxes and 1.4 for indirect taxes. We can compare these implicit assumptions about the income elasticity of tax revenues with the corresponding estimates that can be derived from the available empirical evidence. An analysis of the time-series data covering the ten-year period 1985-86 to 1994-95 shows that the estimated income elasticity of indirect taxes is around 0.8, while the estimated income elasticity of direct taxes is around 1.2. Hence, it is obvious that if we use the empirically derived estimates of the relevant elasticities to project the revenue growth for different types of taxes, we would get much lower rates of growth of tax revenues during 1995-96.

Similarly, the growth of both plan as well as non-plan expenditure has been grossly underestimated. This year's budget estimates are based on the assumption of 14.5% nominal increase in GDP (at current prices) during 1995-96, which consists of an expected growth rate of 6% in real GDP and an overall inflation rate of 8%. Since the Finance Ministry's forecast of annual inflation rate of 8% during 1995-96 appears to be a serious underestimate, we may use a conservative estimate of 10% as the floor level for an assessment of inflationary pressures during the next year. If we evaluate various components of public expenditure incorporated in the budget estimates, we find that the total budgetary support for the plan in 1995-96 (Rs.48,500 crores) represents about 4% increase over the corresponding budget estimates for the previous year but it actually represents a decline of 0.5% in relation to the revised estimates for 1994-95. Thus, in real terms the budgetary support for plan expenditure provided in this budget actually shows a decline of almost 11% (at constant prices). Given the current year's experience, this provision is significantly understated and the actual figures are likely to be significantly higher than the budget estimates. Moreover, the proportion of Central Plan Outlay that is sought to be financed out of internal & extra budgetary resources of public enterprises is projected to increase from 59% in 1994-95 (RE) to 63% in 1995-96 (BE). The assumption underlying this ambitious projection is that the public enterprises will raise Rs.49.9 thousand crores by way of internal and extra budgetary resources during 1995-96 as against Rs.40.4 thousand crores raised last year, which actually represents a shortfall of almost Rs.2.6 thousand crores in relation to the corresponding budget estimates for 1994-95. A similar shortfall in this component of Central Plan Outlay during the next year is most likely, given the current financial position of many central public enterprises and the present state of the capital market. A more detailed examination of the broad sectoral allocation of Central Plan Outlay and the projected growth, especially in real terms, reveals that Central Plan Outlays for sectors like agriculture and social services will show negative growth rates at 1994-95 prices (*Exhibit 5*), while in several other sectors there could be serious shortfalls in the projected growth rates if the expected additional contribution from the extra budgetary resources of public enterprises fails to materialise. Since the next year is going to be the year of general elections, the government will be under tremendous pressure to make up for such shortfalls in Central Plan Outlays. This would contribute to a much higher fiscal deficit than what has been indicated in the budget. According to our calculations, which are based on the past experience of this government as reflected by the comparison of the budget estimates, the revised estimates and the actuals for 1993-94 budget and 1994-95 budget, the actual budgetary support for the plan expenditure is likely to exceed Rs.54 thousand crores as against the budget estimates of Rs.48.5 thousand crores. Similarly, there is likely to be a shortfall of at least around Rs.5 thousand crores in tax revenues projected for 1995-96.

If we examine some items of non-plan expenditure such as food & fertilizer subsidies, we find similar evidence of under-estimation. Total provision for food and fertilizer subsidy in 1995-96 budget estimates is Rs.10.9 thousand crores as compared to 1994-95 revised estimates of 10.8 thousand crores, which actually represents an overshooting by Rs.2.6 thousand crores over the corresponding budget estimates. Thus, we have to believe that the government would be able to contain the food and fertilizer subsidies at the same nominal level in 1995-96 as observed in 1994-95,

despite the inevitable fact that the government is bound to raise the minimum support prices of agricultural products for the forthcoming kharif season, as per the experience of last three years. Since the retail consumer prices in the open market tend to adjust almost automatically to any upward revision in procurement prices, it is obvious that a significant increase in the support prices of essential agricultural commodities would have serious inflationary implications. Moreover, since the government would not be in a position, especially in an election year, to pass on the burden of higher procurement prices to the final consumers by raising the controlled prices within the public distribution system, the necessary and inevitable consequence would be higher subsidies. According to our estimates, the actual level of food and fertilizer subsidy during 1995-96 is likely to be more than Rs.14 thousand crores as compared to the corresponding budget estimates of Rs.10.9 thousand crores.

Thus, a detailed component-wise analysis of the budget estimates for major categories of revenue & expenditure indicates that the actual magnitude of fiscal deficit during 1995-96 is most likely to exceed Rs.72 thousand crores, as against the budgetary provision of Rs.57.6 thousand crores. It may be noted here that, while deriving this estimate, we are not taking into account any unforeseen but not unusual fiscal slippage that may occur either on account of external factors such as drought or internal factors such as granting interim relief to government employees following the interim report of the Fifth Pay Commission.

Available empirical evidence shows a fairly strong correlation between specific measures of deficit and annual rates of inflation in Indian economy. Trends in alternative measures of public deficit are brought out by the figures given in *Exhibit 6*, while a comparative picture of commodity-wise annual inflation rate during 1993-94 and 1994-95 is presented in *Exhibit 7*. It is interesting to observe that, out of the alternative measures of public deficit, the revenue deficit and the fiscal deficit have the highest and statistically significant degree of correlation with annual inflation rates. In fact, an analysis of the data relating to the period 1981-82 to 1994-95 shows that a one percentage point increase in the ratio of revenue deficit to GDP leads to an increase of 1.6 percentage points in the annual inflation rate. Thus, control of fiscal deficit, and more particularly the revenue deficit, appears to be the main solution to the problem of controlling inflation in Indian economy.

The main conclusion that emerges from the above analysis is quite clear. Given the likely magnitude of actual deficit figures which could be truly staggering, the government's ability to control inflation within the single digit level during 1995-96 appears to be highly doubtful and the actual inflation rate is most likely to be around 11% to 12%, and it might even touch 15% if the monsoon fails, which is a distinct possibility (for 1995) that cannot be ruled out given the fact that the 1994 monsoon was the seventh successive normal monsoon setting some sort of an unprecedented historical record. Such high rate of inflation will have serious implications for the exchange rate, the interest rates and even industrial growth. Moreover, high inflation, which this budget would fail to curb, would adversely affect the poor and almost neutralise whatever limited impact the anti-poverty programmes may have on their well-being.

5. Impact on Industry and Capital Market

It is rather unfortunate that the budget for 1995-96 does not contain any specific or direct measures that would provide a fillip to industrial growth and a much needed boost to the stock market. By now it is quite evident that the industry has responded extremely well to various growth-oriented measures taken in the two preceding budgets and as a result the economy is fairly well poised for a smart take-off into the high growth phase. By providing even marginal additional incentives to growth-oriented industries and by removing the so-called "drought surcharge" on the corporate tax, the Finance Minister could have capitalised on the favourable climate for rapid industrial growth created by the process of economic reforms during 1991-94. Instead, he has perhaps opted for a policy of 'wait and watch', which could prove counter productive, especially if the economy were to receive some external shock like drought or international oil price hike or a global recession affecting our major export markets.

From the industry's point of view, some of the positive aspects of the budget are: (a) Further rationalisation and lowering of customs duty structure for the capital goods sector, with more than 80% of the machinery & equipment imports now having a uniform duty rate of 25%; (b) Reduction in customs duty on selected items of industrial raw materials such as plastics, ferrous & non-ferrous metals, non-metallic minerals, chemical feedstock, essential raw materials for synthetic fibres & polyester filament yarn like DMT, PTA & MEG, etc.; (c) Extension of MODVAT credit facility to include fuel cost for captive power generation, which would provide some relief to industries required to depend on inhouse power generation; and (d) Five year tax holiday for companies investing in infrastructure. While these measures will certainly help specific industries to reduce their cost of production, it is not clear whether the extent of actual reduction would be good enough to enable the concerned domestic industry to withstand global competition emerging from a general reduction in customs duty coupled with a significant reduction in the peak rate of duty from 65% to 50%, which would be applicable to some of the corresponding finished products also.

Since the government has a major plan of divestment of public enterprise equity amounting to Rs.7 thousand crores during 1995-96, there is no doubt that a healthy and booming stock market would have helped a great deal in this regard. It is by now empirically well established that the average price realisation of the given portfolio of shares of public enterprises to be divested has been significantly lower during the bearish phase of the stock market. In fact, the experience of the last two years clearly shows that the government has often faced serious difficulties in selling public enterprise equity and, on more than one occasion, the pre-determined divestment plan had to be either shelved or drastically reduced. By contrast, the divestment plan has been highly successful whenever it has been executed during the bullish phase of the market. Hence, the rational expectation was that the Finance Minister would include some measures in the budget that would strengthen the stock market sentiment. Even an already promised measure like withdrawal of 15% surcharge on corporate tax could have gone a long way in boosting the market. Based on a rough & tentative calculation, we feel that the single measure of withdrawing the surcharge would have

lifted up the sensex on the Bombay Stock Exchange by at least around 300 to 400 points, which would have created highly favourable conditions in turn leading to a much higher price realisation for the public enterprise equity to be divested during 1995-96. In fact, it is quite likely that the resulting better price realisation might have more than offset the direct revenue loss that the exchequer might have suffered due to the withdrawal of surcharge.

6 Agenda for Future Reforms

While considerable progress has already been made in bringing about economic reforms in several fields during the last four years, the fact remains that whatever has been achieved represents only a fraction of what needs to be done. The journey on the path of economic reforms is long & arduous and successful completion of this journey requires sustained effort and uncompromising commitment for a long period of time.

The Union Budget for 1995-96 creates an impression that our effort in this direction has already slackened and perhaps complacency has replaced commitment. The budget does not contain anything of consequence that would indicate further progress in the reform process initiated by earlier budgets, especially in the following areas : (a) Reinstating fiscal discipline and curbing excessively high revenue deficit; (b) Bringing about further reforms in indirect taxation through extensive simplification and rationalisation of excise and customs duties along the lines suggested in the Chelliah Committee Report; (c) Reinforcing and strengthening financial sector reforms; (d) Strengthening export orientation of industry as well as agriculture; (e) Arresting the decline in the overall domestic saving rates observed in recent years; and (f) Introducing appropriate exit policy to tackle the problem of growing number of sick and unviable units in the organised sector.

It is heartening that the Finance Minister has himself recognised the need for continuing the reform process by stating that, "We need to redouble our efforts in several areas (*relating to economic reforms*) to consolidate our gains..... This is both feasible and also necessary to achieve our goals". The agenda for future reforms outlined by the Finance Minister includes further reforms in the areas of taxation, trade & industrial policies and the financial sector & insurance sector reforms aimed at enhancing the efficiency and competitiveness of Indian economy. It also includes revamping of public enterprises, providing greater flexibility in the legislation relating to industrial relations, widening and deepening of capital market reforms and improvement as well as modernisation of delivery systems for social services.

The Finance Minister has also clearly emphasised the need to improve fiscal discipline as evident from the following statements in his Budget Speech:

"After the initial success in fiscal consolidation, further progress has proved much more difficult. The fiscal deficit increased sharply in 1993-94 and the pressure on the deficit has continued in 1994-95. These developments must be countered through determined action. If we try to fund every project and

programme irrespective of the revenue available, we only generate high inflation, high interest rates which choke off investment and a proliferation of under-funded incomplete projects. This approach will only jeopardise our basic objective of development with social justice, since it is the poor who will suffer most from the resultant inflation and slow growth of employment opportunities. We must, therefore, ensure that fiscal discipline is further improved in the years ahead".

Thus, the basic problems have been clearly identified and the need to take immediate action has also been emphasised. However, the most disheartening part is that these things have remained only on paper. There is no concrete action plan that has been proposed in the budget to deal with these crucial aspects with a sense of urgency. As already indicated earlier, the fiscal deficit during 1995-96 is in fact likely to increase sharply and reach a staggering level. The VIII Plan period as a whole may, therefore, witness a further sharp deterioration in the situation of fiscal imbalances created during the VII Plan period. After all we should not forget that serious fiscal imbalances witnessed during the VII Plan period were at least partly responsible for the grave economic crisis that the country faced in 1991. To avoid this imminent danger, the Finance Minister should have made an all out effort to tighten the fiscal control and try to achieve as much of fiscal consolidation as possible in the short run. That he has failed to do so is quite evident from the above analysis. It may be argued that the reasons why he failed are essentially political in nature and the formulation of this budget appears to be guided more by political considerations than economic rationale. However, it is high time for Indian politicians to realise that the best strategy to win elections is to achieve a strict control on inflation, which hurts masses, rather than trying to give a few doles to selected groups without being sure about their effective delivery. And the best part of this strategy is that, in the present context, it also represents sound economics.

Exhibit 1

Main Provisions of Union Budget 1995-96

- * Uncovered budget deficit of Rs.5,000 crores.
- * Fiscal deficit of Rs.57.6 thousand crores indicating a decline in the fiscal deficit to GDP ratio from 6.7% to 5.5%.
- * Income tax exemption limit raised from Rs.35,000 to Rs.40,000
- * Exemption under 80-L covering income by way of interest and dividend raised from Rs.10,000 to Rs.13,000.
- * Scope of deduction of tax at source enlarged.
- * Tax concessions for contributions to welfare measures for the handicapped, minorities, literacy and poverty eradication.
- * Peak rate of customs duty further reduced from 65% to 50%.
- * Import Duty structure for machinery and capital goods further rationalised and simplified. Almost 80% of machinery and capital goods items to attract a uniform rate of 25% customs duty.
- * Reduction in customs duty on industrial raw materials and intermediates. Total concessions in customs amounting to Rs.1179 crores.
- * Free baggage allowance for passengers coming to India raised from Rs.4,000 to Rs.6,000.
- * Selective reduction in excise duties on consumer goods including cosmetics, aerated waters, dry cell batteries, fire works, etc.
- * Excise duty on polyester filament yarn reduced from 69% to 57.5%.
- * 7% duty increase on cigarettes, modest increase in excise duty on cement from Rs.330 to Rs.350 per tonne.
- * Duty on plastics reduced from 30% to 25%, aluminium from 20% to 15%, glassware from 20% to 10% and on certain items of china and porcelain from 30% to 15%.

contd..

Exhibit I contd..

- * Extension of MODVAT to include fuel costs for captive power plants. Relaxation in MODVAT rules by allowing MODVAT credit for specified quality control testing, pollution control and R & D equipment.
- * Increase in fertilizer and food subsidy.
- * National Social Assistance Scheme for the benefit of rural poor.
- * New Rural Infrastructural Fund to be set up within NABARD with a corpus of Rs.2,000 crores (to be contributed by commercial banks) to encourage quicker completion of ongoing rural projects.
- * A new scheme providing Rs.1,000 crores (to be contributed by commercial banks) to the Khadi & Village Industries Commission to revamp the khadi & cottage industries.
- * Five-year tax holiday for companies investing in infrastructure.

Exhibit 2

Union Budget 1995-96 at a Glance

(Rs. crores)

		1990-91 Actuals	1991-92 Actuals	1992-93 Actuals	1993-94 Actuals	1994-95 BE	1994-95 RE	1995-96 BE
1	Tax Revenue	42978	50070	54044	53449	62742	64998	74374
2	Non Tax Revenue	11976	15977	20084	22004	23342	23782	26413
3	Revenue Receipts	54954	66047	74128	75453	86084	88770	100787
4	Loan Recoveries	5712	6020	6356	6191	6700	6700	6730
5	Other Receipts	-	3038	1961	-48	4000	5767	7000
6	Borrowing	33303	29470	27861	49297	48915	55035	52634
7	Capital Receipts	39015	38528	36178	55440	59615	67502	66364
8	Total Receipts	93969	104575	110306	130893	145699	156272	167151
9	Interest Payments	21471	26596	31035	36695	46000	44000	52000
10	Revenue Expenditure	73516	82308	92702	108169	118811	122902	136328
11	Capital Expenditure	31800	29122	29916	33684	32888	39370	35823
12	Total Expenditure	105316	111430	122618	141853	151699	162272	172151
13	Revenue Deficit	18562	16261	18574	32716	32727	34132	35541
14	Capital Surplus	7215	9406	6262	21756	26727	28132	30541
15	Budget Deficit	11347	6855	12312	10960	6000	6000	5000
16	Fiscal Deficit (3+4+5-12)	44650	36325	40173	60257	54915	61035	57634
17	Primary Deficit (16-9)	23179	9729	9138	23562	8915	17035	5634

Exhibit 3

Union Budget 1995-96 : Summary Of Receipts

(Rs. Crores)

	Item	1994-95 BE	1994-95 RE	1995-96 BE
I.	Tax Revenue			
	1. Corporation Tax	12480	13250	15500
	2. Income Tax	10925	11000	13500
	3. Interest Tax	1044	1000	1000
	4. Expenditure Tax	210	170	175
	5. Wealth Tax	125	80	90
	6. Custom Duties	25200	26450	29500
	7. Excise Duties	36700	36900	42780
	8. Other Taxes & Duties	452	981	1217
	9. Gross Tax Revenue	87136	89831	103762
	10. Share of States & UTs	24394	24843	29388
	11. Net Tax Revenue	62742	64988	74374
II.	Non-Tax Revenue			
	1. Interest Receipts	15978	16234	18419
	2. Dividends & Profits	2793	2721	2946
	3. External Grants	1365	1176	1154
	4. Other Non-Tax Revenue	3206	3651	3894
	5. Total Non-Tax Revenue	23342	23782	26413
III.	Capital Receipts			
	1. Recoveries Of Loans	6700	6700	6730
	2. Market Borrowings	3700	3700	3700
	3. Treasury Bills	12000	3340	4387
	4. External Assistance	4279	3947	4456
	5. Disinvestment of Equity in Public Enterprises	4000	5237	7000
	6. Small Savings, PPF and Staff PF	7800	15900	10000
	7. Special Deposits & Other Receipts (including zero coupon bonds & loans or conversion of maturing treasury bills)	21136	28678	30091
	8. Total Capital Receipts	59615	67502	66364

Exhibit 4

Union Budget 1995-96 : Summary Of Expenditure

(Rs. Crores)

	Item	1994-95 BE	1994-95 RE	1995-96 BE
1	Non Plan Expenditure			
	a) Interest Payments	46000	44000	52000
	b) Food & Fertilizer Subsidies	8300	10826	10965
	c) Other Subsidies	1084	1643	1436
	d) Debt Relief to Farmers	341	341	-
	e) Defence Expenditure	23000	23544	25500
	f) Pensions	3604	3651	3851
	g) Social Services	2623	2722	2750
	h) Economic Services	3181	4204	3720
	i) Grants & Loans to States	7562	12066	13089
	j) Grants & Loans to Foreign States	276	230	305
	k) Other Items	9146	10284	10035
	Total Non Plan Expenditure	105117	113511	123651
2	Plan Expenditure (4+5)	46582	48761	48500
3	Total Expenditure	151699	162272	172151
4	Central Assistance to State & UT Plans	19304	20827	19506
5	Budgetary Support for Central Plan	27278	27934	28994
6	Internal & Extra Budgetary Resources of Public Enterprise	42863	40382	49855
7	Total Central Plan Outlay (5+6)	70141	68316	78849

Exhibit 5

Central Plan Outlay by Sectors

Item	1994-95 BF	1994-95 RE	1995-96 BE	1995-96 BE 1994-95 Prices	1995-96 % change at constant prices
Agriculture	2637	2853	3022	2747	-3.72
Rural Development	6036	5637	6540	5945	5.46
Irrigation and flood control	261	233	288	262	12.45
Energy	22857	20349	23795	21632	6.3
Industry and Minerals	10394	8872	11598	10544	18.85
Transport	11344	11668	14088	12807	9.76
Communications	7191	7495	8318	7562	0.89
Science, Technology & Environment	1362	1408	1617	1470	4.4
Social Services	7381	8251	8839	8035	-2.62
Others	678	1550	744	676	-56.39
Total	70141	68316	78849	71680	4.92

Exhibit 6

Trends in Central Government Deficit

(Per Cent of GDP)

Year	Budget Deficit	Revenue Deficit	Fiscal Deficit
1975-76	0.5	1.1	4.1
1980-81	1.8	1.5	6.2
1981-82	0.9	0.2	5.4
1982-83	0.9	0.7	6.0
1983-84	0.7	1.2	6.3
1984-85	1.6	1.8	7.5
Average for Sixth Plan	1.2	1.1	6.3
1985-86	2.0	2.2	8.3
1986-87	2.8	2.7	9.0
1987-88	1.7	2.7	8.1
1988-89	1.4	2.7	7.8
1989-90	2.3	2.6	7.8
Average for Seventh Plan	2.1	2.6	8.2
1990-91	2.1	3.5	8.3
1991-92	1.1	2.6	5.9
1992-93	1.8	2.6	5.7
1993-94	1.2	4.3	7.4
1994-95 (RE)	0.7	3.7	6.7
1995-96 (BE)	0.5	3.4	5.5

Source :

- (1) *Economic Survey 1994-95*, Government of India.
- (2) Union Budget 1995-96 (Budget Documents).

Exhibit 7

Annual (Point to Point) Inflation Rate

(Per cent)

	Commodity	Weight	Annual Rate of Inflation	
			1994-95	1993-94
	ALL COMMODITIES	100.00	11.4	9.5
I	Primary Articles	37.29	16.4	8.7
	A. Food Articles	17.39	13.7	3.7
	B. Non-food Articles	10.08	21.2	16.5
	(a) Fibres	1.79	34.0	56.2
	(b) Oil Seeds	3.86	25.7	6.1
	C. Minerals	4.83	4.8	19.6
II	Fuel, Power, Light & Lubricants	10.66	1.6	15.2
III	Manufactured Products	57.04	11.1	8.9
	A. Food Products	10.14	11.3	12.2
	B. Others			
	(a) Textiles	11.55	17.3	12.2
	(b) Cement	0.86	15.9	-1.1
	(c) Iron & Steel	2.44	7.0	11.0
	(d) Fertilizers	1.75	10.6	-0.1
	(e) Non-ferrous Metals	0.57	21.5	-1.3
IV	Administered Items	15.93	2.6	15.4
	(a) Petroleum crude & natural gas	4.27	4.0	21.2
	(b) Petroleum products	6.67	-0.1	7.4
	(c) Coal Mining	1.26	5.2	17.9
	(d) Electricity	2.74	2.8	29.2
	(e) Urea N-content	0.99	21.4	0.0
V	Seasonal Items	34.40	15.3	9.3
VI	Raw Materials	14.91	17.9	17.1

Source : *Economic Survey 1994-95*, Ministry of Finance, Government of India.

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