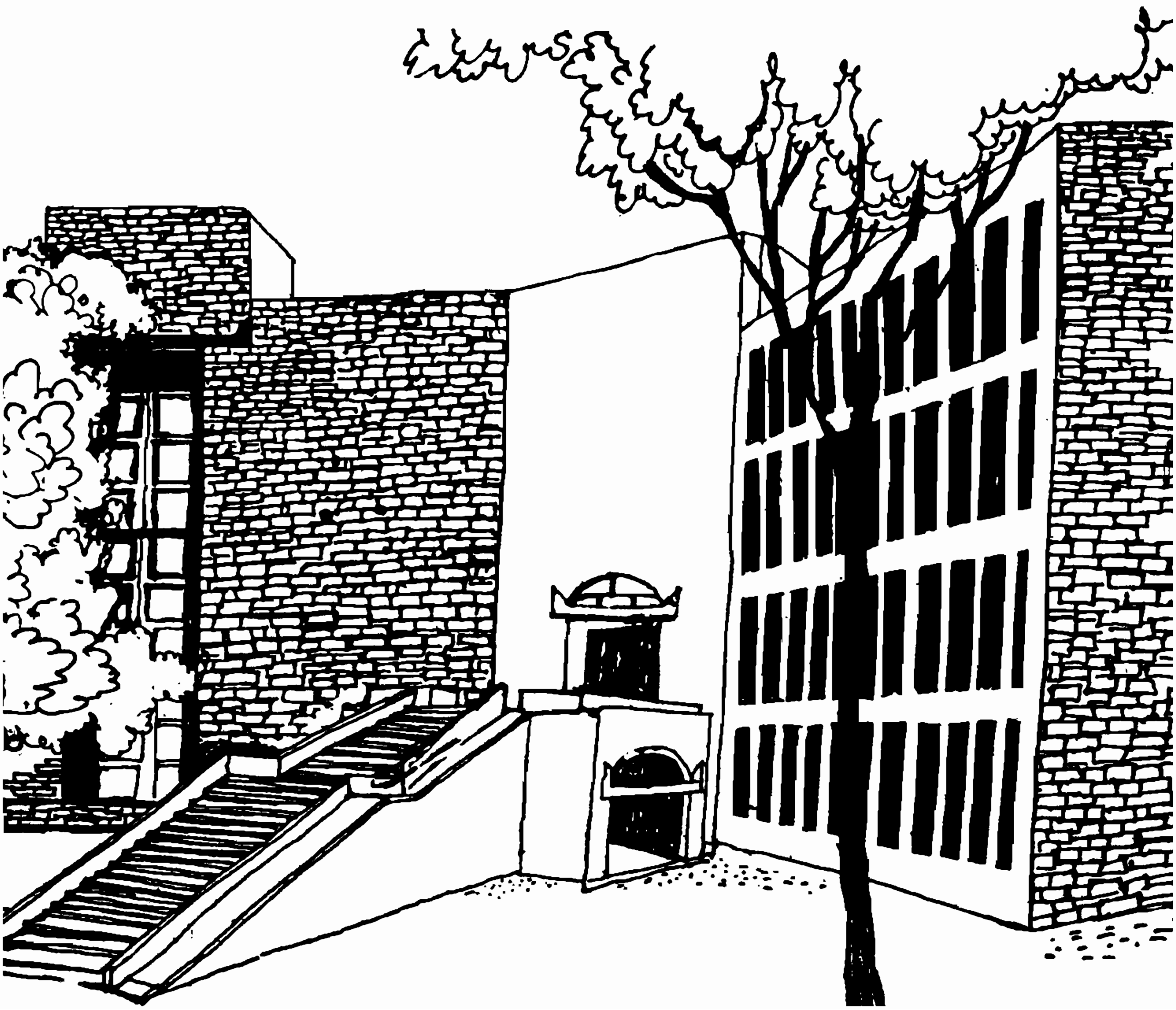
Working Paper



Macroeconomic Analysis of the Union Budget 1997-98

By
Bakul H. Dholakia
RBI Chair Professor
Indian Institute of Management
Ahmedabad

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INDIAN INSTITUTE OF MANAGEMENT
AHMEDABAD 380 015
INDIA

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RBI Chair Professor
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Abstract

The Union Budget for 1997-98 has been widely acclaimed as a historic budget. In view of the serious differences among different members of the coalition government on major economic issues ranging from the size of fiscal deficit to the level of administered prices & subsidies, the situation facing the Finance Minister called for both guts and confidence to formulate a reform & growth oriented budget. In a rare display of the initiative and the required guts, the Finance Minister acted decisively in favour of the top half of the country's population and in the process earned an overwhelmingly favourable public response to his budget proposals. An attempt has been made in this paper to present a broad macroeconomic analysis of the main proposals of the Union Budget 1997-98 and examine the likely impact of the budget proposals on Indian economy. An attempt has also been made to present the post-budget macroeconomic scenario for Indian economy for the year 1997-98.

MACROECONOMIC ANALYSIS OF UNION BUDGET 1997-98

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1. The Background

In the light of a lackluster maiden budget presented by Mr.P. Chidambaram in July 1996 and the subsequent lack of new initiatives for economic reforms during the rest of 1996, the general expectations from his second budget had dampened considerably. By January 1997, the political uncertainties associated with a coalition government in a hung Parliament and the possibilities of a foreign exchange crisis had posed serious question marks on the formulation of the Union Budget for 1997-98. In fact, the critics of economic reforms initiated in 1991 had predicted serious foreign exchange crisis in 1996-97 mainly on account of the expected sharp increase in debt service payments following the repayment of India Development Bonds maturing in February 1997. India Development Bonds floated in 1991-92 carried no annual interest payments and the entire repayment of the principal along with interest amounting to US $ 2.2 billion was due in 1996-97. However, this repayment passed off peacefully and there was no crisis whatsoever. On the contrary, despite the peaking of debt service payments to US $ 14.5 bn. in 1996-97, the foreign exchange reserves actually increased from $ 17 bn. in March 1996 to more than $ 19.8 bn. by February 1997. And this happened in spite of a significant slow down in the growth of exports during 1996-97. Thus, India's position on foreign exchange front actually turned out to be more comfortable in February 1997 than it was a year ago.

Since there was no undue pressure on the exchange rate nor was there any crisis of confidence among the international investor community at the time when the Union Budget for 1997-98 was being formulated, the main issues that the Finance Minister had to tackle while formulating the Budget were more internal than external in nature. The rising rate of inflation, the industrial slow down, the slow down in the growth of exports, failure of infrastructural investment to pick up, relatively higher interest costs, relatively depressed sentiments of the stock market and growing fiscal indiscipline were the main problems facing the Indian economy in 1996-97. Yet another year of good monsoon and the resulting boom in agriculture came as God's gift for the present government preventing the industrial slow down to translate itself into an overall economic slow down. Thus, the overall economic growth in 1996-97 was expected to be healthy and the external situation under reasonable control with very little possibility of any serious economic crisis in the foreseeable future. This macroeconomic background did provide enough opportunity to the Finance Minister to aggressively pursue the long unfinished agenda of economic reforms and take some hard but essentially unavoidable economic decisions without any further delay. However, while the economic agenda was quite clear, it was widely feared that the required political will for taking decisive action might be lacking and, as a result, another great opportunity could be missed. The Union Budget for 1997-98 needs to be viewed in this context.

With serious differences of opinion among different members of the coalition government on major economic issues ranging from the size of fiscal deficit to the level of administered prices & subsidies, the situation facing the Finance Minister was grim. It called for both guts and confidence to capitalise on the excellent opportunity presented by a favourable economic environment by formulating a reform & growth oriented budget. In a rare display of the required guts, confidence and foresight, Mr. P. Chidambaram presented on February 28, 1997 what has been widely acclaimed as a historic budget. Through a bold display of the initiative and the will to act, the Finance Minister successfully cleared the lingering doubts in the minds of many and proved his critics wrong. The overwhelmingly favourable public response and the general acclaim from industrialists, economists and the capital market fraternity received by the 1997 Budget have been unprecedented in the post-Independence history of Indian economy.

2. Objectives of the Budget

The main objectives of the Union Budget for 1997-98 are :

(a) to create an appropriate climate for rapid industrial growth by providing the long awaited boost to the capital market;

(b) to restore fiscal discipline;

(c) to accelerate the development of infrastructure sectors; and

(d) to stimulate domestic savings.

The Finance Minister deserves the maximum applause for showing the courage to act decisively in favour of the top half of the country's population and, in the process, put the economy back on the path of economic reforms, which had unfortunately been pushed back in his previous budget.

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. In what follows, we have made an attempt to analyse the main proposals and provisions of the Union Budget 1997-98 aimed at achieving each of the above-mentioned objectives and the impact that these measures are likely to have on Indian economy during 1997-98. 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. Direct Tax Proposals

One of the main reasons why Mr. P. Chidambaram's second Budget was so well received by all sections is the major direct proposals contained in the Budget. The direct tax proposals relating to the personal income tax as well as the corporate tax deserve a careful assessment as they are likely to have far reaching consequences.

3.1 *Personal Income-tax*

The most significant aspect of the Budget is the bold reduction in all slabs of personal income tax rates, enlargement of the middle income slab and enhancement of the standard deduction for salaried tax payers. These measures coupled with the conceptually sound but operationally difficult scheme of presumptive taxation should actually go a long way in correcting the existing imbalance between the salaried tax payers and others. The net gains to the existing tax payers resulting from the wide ranging income tax exemptions announced in the Budget are likely to be quite large. For instance, a tax-payer earning more than Rs. 3 lakhs per annum will gain more than Rs.30,000. Thus, for the tax-paying upper income groups, this Budget bonanza is equivalent to a 10% increase in their net annual income.

To assess the overall magnitude of income tax concessions, we need information on the category-wise taxable income reported by the total number of tax payers, currently estimated at around 12 million. While this information is not readily available for the assessment year 1996-97, it can be derived from the relevant data compiled from various sources such as the Chelliah Committee Report and CMIE reports through appropriate estimation methodology. Our estimates of the category-wise number of income-tax payers for the financial year 1996-97, so derived, are given in *Table 1*.

Table 1
Distribution of Income Tax Payers and Tax Paid, 1996-97

Taxable Income Category	No. of Tax Payers (in '000)	Average Tax Paid (Rs.)	Total Tax Paid (Rs. Crores)
40,000 to 60,000	3000	1,500	450
60,000 to 1,00,000	7000	9,000	6,300
1 lakh to 2 lakhs	1600	33,000	5,280
2 lakhs to 5 lakhs	300	113,000	3,390
5 lakhs to 10 lakhs	88	273,000	2,402
More than 10 lakhs	12	573,000	688

According to our estimates, as many as 10 million tax payers out of the total number of 12 million tax payers in the country report a taxable income not exceeding Rs.1 lakh and their total contribution to the aggregate income tax revenue is only Rs.6,750 crores. Thus, 83% of the income tax payers contribute only 36% of the total tax revenue, while the remaining 17% contribute the balance 64% of the aggregate income tax revenue. Given this distribution of tax payers, our estimate of the net gains accruing to the existing income tax payers from all income tax exemptions announced in the Budget taken together turns out to be as high as Rs.7,500 crores.

The direct implication of the above estimates is that the aggregate income tax revenue in the financial year 1996-97 at the reduced rates and other concessions announced in the Union Budget for 1997-98 would have been only Rs.11,300 crores instead of the revised estimate of Rs.18,800 crores reported in the Budget documents. As against this, the Finance Minister is actually expecting an increase in the total income tax revenue from Rs.18,800 crores in 1996-97 to Rs.21,700 crores in 1997-98. Thus, the expected increase in the personal income tax revenue implicit in the budget turns out to be as high as Rs.10,500 crores, which implies an increase of 93% considering the situation that would have prevailed in 1996-97 with the 1997-98 tax structure proposed in the budget.

It follows from the above analysis that the budget estimates of income tax revenue for 1997-98 are based on highly optimistic assumptions regarding the overall buoyancy of direct tax revenue. While the post-1991 period witnessed a significant buoyancy in the direct tax revenue, it is attributable mainly to the relatively much faster nominal growth of non-agricultural incomes (around 18% p.a.) and the estimated income elasticity of 1.25 for the personal income-tax revenue (computed on the basis of time-series data for the period 1985-86 to 1996-97). The expected increase in income tax revenue during 1997-98 using this estimate of income elasticity and the projected growth of nominal GDP would not exceed Rs.2,500 crores. Even if we make an additional special provision to take into account the likely impact of the Fifth Pay Commission in terms of incremental tax liability for salaried tax payers in the public sector, the expected buoyancy of income tax revenue during 1997-98 is unlikely to exceed Rs.3,000 crores. Thus, the Finance Minister has made the tacit assumption that the revenue gap of Rs.7,500 crores arising out of the personal income tax concessions given in the budget will be fully covered through the three new measures proposed in the Budget, viz., (a) scheme of widening of income tax net to cover non-tax paying residents of metropolitan cities; (b) introduction of a new Estimated Income Scheme for retail traders having a total turnover of less than Rs. 40 lakhs; and (c) Voluntary Disclosure Scheme (VDS).

Given the substantial scope for ambiguity and discretion in the identification and assessment of the likely new assessees, whose number could be anywhere between 5 to 8 million, this task would indeed be a herculean task. The increase in the workload of the Income tax Department would be enormous and it would require proper computerised information systems and a significant increase in the efficiency of income tax personnel to achieve this ambitious target of additional tax revenue. If this target is not realised, there would be a major shortfall in tax revenues leading to higher fiscal deficit. It must, however, be said that the new Voluntary Disclosure Scheme is going to be so highly attractive that it may receive much greater response than all earlier eight schemes announced during the last four decades taken together, and, to that extent, there is some scope for additional resource mobilisation. Moreover, any movement towards world class tax rates cannot succeed in mobilising higher resources, if it is not backed up by world class tax administration. However, notwithstanding the likelihood of greater success for the proposed VDS and the possibility of some improvement in the overall efficiency of tax administration, it is doubtful whether the massive additional tax mobilisation effort assumed in the budget would materialise during 1997-98. It is unlikely that the additional tax mobilisation resulting from the three new measures proposed in the budget would exceed Rs.3,000 crores. Thus, even under optimistic assumptions, it is most likely that there will be a shortfall of at least around Rs.4,000 crores in the budget estimates for income tax revenue.

3.2 *Corporate Tax*

The main proposals relating to the corporate tax are : (a) withdrawal of 7.5% surcharge on corporate tax; (b) significant reduction in corporate tax rates for domestic as well as foreign companies; (c) introduction of carry forward system in MAT coupled with full exemption of export profits; (d) significant reduction in the tax rate payable by the corporate sector on the royalty and technical services fees to foreign companies; and (e) abolition of the tax on dividends in the hands of the shareholders coupled with the introduction of a new tax on distributed profits at the rate of 10% payable by the companies paying dividends.

These proposals will have a significant favourable impact on the overall tax liability and the net profitability of the corporate sector. A quick estimate based on the CMIE data relating to the corporate sector for the last two years indicates that the likely magnitude of corporate tax concessions (withdrawal of surcharge and reduction of rates) will be Rs.3,600 crores. This overall tax gain will be partly nullified by the imposition of the dividend tax. Given the dividend policies and the corporate profitability structure observed during 1995-96 and 1996-97, the dividend tax is likely to impose an additional tax liability of Rs.1500 crores on the corporate sector. Thus, the net tax gain accruing to the corporate sector from the budget proposals is expected to be around Rs.2,100 crores, which implies that the overall increase in the corporate tax revenue assumed in the budget is as high as Rs.5,000 crores. Since the estimate of income elasticity of corporate tax revenue derived from the time-series data for 1985-86 to 1996-97 is only 1.10, the expected increase in the corporate tax revenue of the order of Rs.5,000 crores is unlikely to materialise. There is a distinct possibility, therefore, of a shortfall of at least around Rs.2,000 crores in the budget estimates for corporate tax revenue during 1997-98.

4. Indirect Tax Proposals

The Budget contains several proposals relating to the customs and excise duties aimed at lowering the duty rates and rationalising the duty structure.

4.1 *Customs Duties*

The Finance Minister has aggressively pursued the tariff reform agenda in the Union Budget for 1997-98. With the overall objective of "bringing India's tariffs in accord with world levels", the Finance Minister has proposed to reduce the peak rate of customs duties from 50% to 40% and also significantly reduce the duty rates on a large number of specified groups of items such as capital goods, project imports, inputs for several industries including steel, chemicals & textile machinery, steel products, telecom & computer equipment, etc. The revenue loss resulting from the proposed reductions in customs duties is estimated to be Rs.2,625 crores. The budget estimates for 1997-98, however, indicate an increase in the customs revenue from Rs.44.1 thousand in 1996-97 (RE) to Rs.52.6 thousand crores in 1997-98 (BE), which in effect implies an increase of more than Rs.11 thousand crores (i.e., more than 25%). This target can be achieved if the industrial sector is buoyant and consequently the import growth, which was sluggish during 1996-97, picks up during 1997-98.

The customs revenue increased by Rs.7 thousand crores during 1996-97, but almost half of this increase was on account of the increased customs revenue from imports of crude oil and petroleum products, where the rising international prices of these items played a major role. In fact, during 1996-97 the customs revenue from several categories of imports such as iron & steel intermediates, steel products, project imports, etc. actually registered a decline. Significant acceleration in the growth of the industrial sector and the consequent revival of international trade are, therefore, the basic assumptions underlying the optimistic growth projections for the customs revenue. In the light of the most recent information available on the trends in industrial production and international trade during the first four months of 1997, it is doubtful whether there will be a significant pick up in the growth of exports and imports during the first quarter of 1997-98. Hence, according to our estimates, there is a likelihood of a shortfall of around Rs.2,000 crores in customs collections during 1997-98, unless the Rupee depreciates significantly or the international price of crude oil increases significantly during the second half of 1997-98.

4.2 ***Excise Duties***

The basic purpose of the proposals relating to excise duties is to attempt further simplification and rationalisation of the existing excise duty structure which is still fairly complex and full of distortions. The ultimate objective of excise reform, as clearly spelled out by the Finance Minister, is to "have a four-rate structure" and "eventually gravitate towards a mean rate of around 18%". With this purpose in view, the Finance Minister has introduced three new rates, viz., 8%, 13% & 18% and removed the existing rates of 20% & 10%, though the rate of 15% has been retained for the time being. Minor to medium range excise concessions have been given on a number of items of mass consumption, while the excise exemptions granted earlier to certain items (like jams, jellies, pens, etc.) have been withdrawn and the excise duty on cigarettes and biris has been raised. The excise structure for the small scale sector has been fully revamped and a graded flat rate scheme has been introduced for the small scale units having annual clearances upto Rs.1 crore. The basic purpose of the revised excise scheme for the small scale units is to relieve them from the requirement of maintaining complicated records for availing Modvat and also avoid the complexities involved in determining the exact classification of goods for computing the tax liability.

On the whole, the proposals relating to the excise duties are said to be revenue neutral. However, the Finance Minister has claimed that, as a result of his budget proposals, the basket of commodities consumed by an average citizen "will carry a significantly lower tax burden". Two aspects deserve special consideration in this context. Firstly, while the wide ranging excise concessions on items of mass consumption are welcome, there may not be any perceptible difference in the retail prices of these products because the cascading effect of freight hike proposed in the Railway Budget might actually nullify the effect of excise reduction. Moreover, in view of the rising deficit in oil pool account, the possibility of a fairly substantial price hike in diesel and petroleum products latest by the end of June cannot be ruled out; and, as a result, the final retail prices for most items where excise concessions have been given in this Budget may actually turnout to be the same or even higher by July 1997. Secondly, the Finance Bill 1997 proposes to amend the Central Excise Act, 1944 to make a specific provision for charging of excise duty on specified goods (mostly packaged items) with reference to their maximum retail price. This provision, when implemented, would actually shift the tax base for excise duty from the existing ex-factory price to the retail price and thereby automatically lead to an increased burden of excise on the respective commodities.

The revenue from excise duties is expected to increase from Rs.46.2 thousand crores in 1996-97 (RE) to Rs.52.2 thousand crores in 1997-98 (BE). It should, however, be noted that during 1996-97 an increase of about Rs.5,900 crores in excise revenue was budgeted but there was a shortfall of about Rs.700 crores in excise collections. In 1995-96 also there was a shortfall in excise collections of about Rs.1,800 crores. In view of this kind of past experience, the possibility of a shortfall of Rs.500 crores to Rs.1,000 crores in excise collections during 1997-98 cannot be ruled out.

A major proposal in the Budget relating to indirect taxes is the one involving the taxation of the service sector. The service tax which was introduced earlier is proposed to be extended to cover a number of additional services such as transportation of goods by road, air-travel agents, tour operators, car rental agencies, consulting engineers, out-door caterers, man-power recruitment agencies and certain categories of clearing & forwarding agents. The revenue mobilisation resulting from these proposals on the service tax is estimated to be Rs.1,200 crores. While these proposals are well-meaning, serious doubts persist about various issues involved in the actual implementation of each of these proposals.

5. Fiscal Deficit

The Finance Minister has claimed a major success in his endeavour to control the fiscal deficit in his second budget, as the magnitude of fiscal deficit during 1997-98 is estimated to be Rs.65.5 thousand crores which represents only 4.5% of GDP. Moreover, the Finance Minister has also taken credit for ensuring that the fiscal deficit would not exceed 5% of GDP during 1996-97 as per the revised estimates. Thus, he proudly states in his Budget speech that, "I am profoundly sorry to disappoint my well-meaning critics" (who had argued that the actual level of fiscal deficit during 1996-97 would turn out to be much higher than budgeted); and "I have not wavered in my commitment to continue on the course of fiscal correction" (indicating further reduction budgeted during 1997-98). It would be interesting to examine the validity of these claims.

An important aspect of the control of fiscal deficit is the control of public expenditure. Some relevant information regarding the trends in selected components of public expenditure is presented in *Table 2*.

Table 2
Trends in Selected Components of Public Expenditure

(Rs. 000 crores)

Component of Public Expenditure	1995-96 (RE)	1996-97 (BE)	1996-97 (RE)	1997-98 (BE)
Aggregate of interest payments, defence expenditure & subsidies	90.9	102.5 (12.8%)	102.2 (12.4%)	120.7 (18.1%)
Transfer from Centre to States (Grants, Loans & Plan Assistance)	36.3	40.1 (10.5%)	42.6 (17.4%)	43.8 (2.8%)
Provision for Fifth Pay Commission recommendations	--	4.0	--	4.2
Other Expenditure	55.8	58.0 (3.9%)	57.5 (3.1%)	63.5 (10.4%)
Total Expenditure	183.0	204.6 (11.8%)	202.3 (10.5%)	232.2 (14.8%)

While evaluating the government's success in controlling the quantum of fiscal deficit during the financial year 1996-97, the first thing that needs to be noted is that in absolute terms the fiscal deficit actually exceeded the budget estimate by Rs.1,000 crores. Secondly, the provision of Rs.4,000 crores made in the 1996 budget for implementing the Fifth Pay Commission's recommendations was not actually utilised which resulted in the corresponding unintended saving of public expenditure. Thirdly, against the allocation of Rs.2,500 crores for the Rural Infrastructure Development Fund, the amount actually disbursed during the financial year 1996-97 was less than Rs.1,500 crores, resulting in an unintended saving of more than Rs.1,000 crores. Thus, had such unintended savings not occurred, the magnitude of fiscal deficit during 1996-97 would have turned out to be more than Rs.69 thousand crores (i.e., 5.5% of GDP) instead of the budgeted level of Rs.62.3 thousand crores (i.e., 5% of GDP). Hence, there is not much to cheer about the effective control of fiscal deficit during 1996-97.

According to the budget estimates for 1997-98, the fiscal deficit will be Rs.65,454 crores, i.e., 4.5% of projected GDP. If the fiscal deficit can actually be restricted to the budgeted level, it should indeed be regarded as a major achievement under a fairly difficult socio-political environment. In fact, it would also represent some sort of a miracle because a large number of tax concessions in the field of both direct as well as indirect taxes have already been proposed in the budget and simultaneously expenditure on subsidies has been increased and several new schemes for the poor have also been announced in the budget. However, the chances of the fiscal deficit being contained within its budgeted level do not appear to be very bright, especially in the light of the analysis of tax proposals presented above coupled with the information on the relevant components of public expenditure given in *Table 2.*

It is evident from our analysis of direct & indirect tax proposals that there is a sizeable over-estimation of the expected revenue from each of the major tax categories. Thus, the overall revenue shortfall from personal income-tax, corporate tax, customs and excise duties is likely to be at least around Rs.8,000 crores during the financial year 1997-98. On the expenditure side, there appears to be a considerable under-estimation, especially in the case of the major component relating to the transfer of budgetary resources from the Centre to the States. As shown in *Table 2*, this major component, which accounts for more than one-fifth of total public expenditure, is budgeted to increase in nominal terms by less than 3% during 1997-98, thereby actually indicating a significant decline in real terms. Finance Ministry's assumption regarding their ability to exercise such a tight control on what essentially represents a politically sensitive & crucial item of Central Government's expenditure can only be considered as highly optimistic and farfetched. Given the nature of coalition government at the Centre, which is mainly dominated by the regional parties, and the United Front's political philosophy of allowing the State Governments to have a greater say and a higher autonomy, it is difficult to imagine how a programme of effectively reducing the transfer of resources from the Centre to the States can be meaningfully implemented in the present context. This feeling is readily corroborated by the available evidence relating to the actual experience in this regard during the financial year 1996-97. As shown in *Table 2*, the transfer from Centre to States as a component of total expenditure was budgeted to increase in nominal terms by 10.5% during 1996-97; but, as per the revised estimates now available, it actually increased by 17.5%. Thus, the rate of increase of this component of expenditure not only exceeded the budgeted rate but also turned out to be significantly higher than the corresponding rate of increase of total expenditure during 1996-97. A similar story is likely to be repeated during 1997-98. As a result, we expect the actual level of total expenditure to exceed the budgeted level by at least Rs.6,000 to 7,000 crores, going by the past experience and the current pattern of public expenditure.

Thus, according to our estimates, the likely level of fiscal deficit during 1997-98 will be around Rs.79 thousand crores rather than Rs.65 thousand crores indicated in the budget estimates. The fiscal deficit- GDP ratio would, therefore, actually turn out to be 5.5% and not 4.5%, as indicated by the Finance Minister. If that happens, it would imply that for all practical purposes no further fiscal correction would have been achieved during the last two years.

The overall situation on the fiscal discipline front may even turn out to be worse than what has been indicated above because of the distinct possibility that the Central Government's fiscal problem is now actually being pushed to the State Governments resulting in a significant increase in the State-level fiscal deficit. With the regional parties dominating the current political scene and the growing competition among different political parties in various states to introduce populist schemes effectively costing huge amounts to the state exchequers, there is already a clearly emerging trend for the state level fiscal deficit to increase, especially after 1994. The information on the state level fiscal deficit is provided in *Exhibit 5*.

The consolidated gross fiscal deficit of the State Governments is budgeted at Rs.36,498 crores in 1996-97, which represents a sharp increase of 80% from the corresponding amount of Rs.20,596 crores in 1993-94. In fact, during the period 1990-91 to 1993-94, the consolidated gross fiscal deficit of State Governments increased by less than Rs.2,000 crores (i.e., only around 10%). Moreover, during the last four years, there is a significant increase in the number of State Governments showing a revenue deficit. As many as 15 State Governments have budgeted revenue deficits during the financial year 1996-97, and this number is likely to increase further during 1997-98. Thus, even if the Finance Ministry achieves a moderate success in controlling the Central Government's fiscal deficit (which is unlikely as we have argued above), the country's fiscal problem would continue to remain unsolved because of the growing fiscal indiscipline at the state level.

6. Impact on the Capital Market

Viewed from the angle of Indian capital market, this Budget is the most market-friendly Budget presented since 1991. The removal of tax on dividends in the hands of the shareholders, significant reduction in the corporate tax, significant concessions in personal income tax, possibility of the buy-back scheme to be introduced in near future, the enhancement of FII investment limit, reduction in the capital gains tax rate (arising on transfer of securities) for non-resident Indians, modifications in MAT and the promise to initiate the movement towards capital account convertibility based on the road map suggested by the RBI expert group are the measures which would go a long way in providing a fillip to the stock market. In fact, this significant package of proposals would facilitate the commencement of the bullish phase, which could result in a significant upward shift of the lower support level for Sensex. The sustainable Sensex bottom attracting spontaneous support is most likely to increase from the level of around 3200 witnessed during 1996 to 3700 during 1997 indicating an upward shift of more than 15%. Moreover, there would be at least a couple of reasonably durable but essentially short spells when the Sensex might actually cross 4200 mark during 1997.

A healthy and booming stock market would not only provide the much needed resources to the well managed companies but also pave the way for a smooth and satisfactory implementation of the disinvestment programme envisaged in the Budget in sharp contrast to the bad experience of earlier divestment programmes during 1995 and 1996. The post-budget behaviour of the Stock Market has been quite encouraging and the market seems to be clearly heading towards a bullish phase as indicated by the performance indicators of the Bombay Stock Exchange and the National Stock Exchange shown in *Table 3*.

Table 3
Post-Budget Behaviour of BSE & NSE Indices

Period	BSE Sensex	NSE Index
Pre-budget closing (Feb. 27)	3428	923
Two weeks after the Budget	3745	1070
Ten weeks after the Budget	3769	1053
Fifteen weeks after the Budget	4030	1136
Extent of increase in 15 weeks	602 (18%)	213 (23%)

Thus, within a period of less than four months after the budget, the stock market has already registered an increase of around 20%. Moreover, during the entire post-budget period so far, the BSE Sensex has generally remained above the level of 3700.

7. Post-Budget Macroeconomic Scenario

During the conventional post-budget briefing by the senior officials of the Finance Ministry on March 1, 1997, it was clearly indicated that the budget envisaged an overall growth rate of more than 7% and an inflation rate of 6.5% to 7% during 1997-98. The Finance Minister also mentioned in his first post-budget press interview that his budget was "leading to an economy which is sustaining 7% growth, aiming at 8%" and emphasised that, "inflation control in the coming financial year is a key concern of the government". The budget estimates for 1997-98 are based on the assumption of 14.5% to 15% projected growth rate of nominal GDP at market prices.

In view of the detailed analysis of the budget proposals presented above, it is evident that the overall inflation rate during the next year is likely to be around 9% and it is indeed doubtful whether this could really curb the inflationary expectations in the economy, as the Finance Minister has claimed in his Budget Speech. The other negative aspects of the Budget are its failure to provide any direct measures to boost the stagnating level of manufactured exports, lack of significant initiatives for infrastructure development and the failure to introduce major reforms in the insurance sector. Moreover, if the imports pick up as a result of significant reduction in customs and the manufactured exports fail to revive, the expected high rate of inflation may result in a further depreciation of the Rupee by about 3% to 4% before the end of 1997-98, unless there is a huge inflow of foreign portfolio investment and foreign direct investment during the first half of 1997-98 following the highly favourable reaction to the budget.

The latest information available on India's foreign trade, given in *Table 4*, reveals a significant slow down in the growth of exports as well as imports during 1996-97. The growth rate of exports declined from 21% achieved in 1995-96 to 4% in 1996-97, while the growth of rate of imports declined from 27% recorded in 1995-96 to 6% in 1996-97. In fact, the entire growth of imports during 1995-96 was on account of the increase in the oil import bill and the non-oil imports actually declined in absolute terms during 1996-97.

Table 4 **Recent Trends in India's Trade Deficit** (Figures in US $ Billion)			
	1995-96	1996-97	Percentage Change
Exports	31.83	33.10	4.0%
Imports	36.36	38.54	6.0%
Oil Imports	7.15	9.61	34.4%
Non-oil Imports	29.21	28.93	-1.0%
Trade Deficit	4.53	5.44	20.1%

There is an equally strong evidence available now about the slow down in the growth of industrial production during 1996-97. *Table 5* shows the comparative growth rates of major industrial categories observed during the first eleven months (April to February) of 1996-97 & 1995-96. While a significant deceleration in the growth of industrial output has been experienced by each industrial category, the decline in the average growth rate has turned out to be quite sharp in the case of capital goods and consumer durables. Consequently, as compared to the high growth rates of more than 9% in 1994-95 and 12% in 1995-96, the actual growth of industrial output is unlikely to exceed 7% during 1996-97. Thus, the Finance Ministry's optimistic projection of the continuation of double-digit industrial growth rate during 1996-97, made in the last year's budget, has unfortunately not materialised and there is a distinct possibility of this trend of decelerating industrial growth continuing during the first quarter of 1997-98.

Table 5 **Recent Trends in the Growth of Industrial Output**		
Industrial Category	1996-97 (April to February)	1995-96 (April to February)
Basic goods	6.8%	8.7%
Capital Goods	9.5%	18.4%
Intermediate Goods	7.7%	10.0%
Consumer Goods (Total)	4.6%	12.8%
Consumer Durables	5.0%	35.4%
Consumer Non-durables	4.4%	7.1%
Total Industrial Output	6.9%	11.5%
Source : *Central Statistical Organization*, Government of India.		

The latest available information on corporate performance tells the same story. In 1996-97, the growth of the corporate sector has declined for the first time since the industrial recovery started during the post-reform period. The rapid growth of sales as well as net profits achieved by large, medium & small companies during 1993-94 to 1995-96 is not visible in 1996-97. We find that not only has the growth of sales and net profits slowed down in several cases, there are also many companies which have actually shown a decline in their net profits during 1996-97. Thus, the Indian corporate sector is slowly but surely entering a new phase of shake-outs in 1997 and the famous principle of the survival of the fittest in a competitive environment is now beginning to play an important role in Indian economy. An assesment of the emerging post-budget macroeconomic scenario for 1997-98 assumes special significance in this context.

Our forecast of the overall post-budget macroeconomic scenario for 1997-98 is presented in *Table 6*. Given the present state of uncertainties regarding both the global economic environment as well as the domestic political environment, we have presented the forecast relating to two alternative scenarios : the optimistic scenario based on the assumption of a favourable global economic environment, favourable weather conditions & political stability; and the pessimistic scenario based on the assumption of a less favourable global economic environment, unfavourable weather conditions & political uncertainties.

Table 6
Post-Budget Macroeconomic Forecast for 1997-98

Macroeconomic Variable	Finance Ministry's Projection	Our Forecast	
		Optimistic Scenario	Pessimistic Scenario
GDP Growth	7.5%	7.5%	5%
Industrial Growth	10%	12%	7%
Inflation Rate	6.5%	8%	12%
Fiscal Deficit (% of GDP)	4.5%	5%	6%
Export Growth	NA	20%	10%
Import Growth	20%-22%	22%	15%
Foreign Investment	$ 10 bn.	$ 10 bn.	$ 5 bn.
Exchange Rate (March 1998)	NA	$ 1 = Rs.37	$ 1 = Rs.39
Forex Reserves (March 1998)	NA	$ 25 bn.	$ 18 bn.

In the light of the forecasts presented above, it is evident that there is a high degree of optimism implicit in the Finance Ministry's projections of the fiscal deficit and the inflation rate, which are unlikely to materialise even under the optimistic scenario. Our post-budget macroeconomic forecast under the pessimistic scenario is to be viewed more like an advance warning of the rough weather that the Indian economy may have to face during the course of its attempt to take off into the high growth phase. While the budget for 1997-98 has taken a few definite steps to stimulate the Indian economy for this take-off, it does not contain any contingency plan to deal with adverse conditions associated with a pessimistic scenario. A strong & decisive corporate response to economic reforms and the emerging competitive pressures should in fact represent the ideal instrument to tackle such contingencies. That is perhaps the main reason why this budget has focussed more on the corporate sector than any of the earlier budgets during the post-reform period. If the corporate sector delivers what is expected of it, the Indian economy may well be cruising along the path much closer to the one outlined under the optimistic scenario and that would certainly pave the way for the Indian economy to emerge as a new Asian tiger by the turn of the century.

Exhibit 1

Main Provisions of Union Budget 1997-98

1. Reduction in fiscal deficit from 5% of GDP in 1996-97 to 4.5% of GDP in 1997-98. Primary deficit eliminated altogether with interest payments exceeding the overall fiscal deficit.

2. Monetized component fiscal deficit placed at Rs.16,000 crores representing about one-fourth of the aggregate fiscal deficit of Rs.65,454 crores.

3. Significant increase in food & fertilizer subsidy and in defence expenditure.

4. Significant reduction in Income-tax rates on all slabs from the existing levels of 15, 30 and 40 per cent to 10, 20 and 30 per cent, respectively. Upward revision in the income range for the higher income slabs.

5. Standard deduction raised to Rs. 20,000. Income tax exemption for senior citizens up to Rs. 1 lakh.

6. Widening of income tax net to cover non-tax paying residents of metropolitan cities who satisfy any two of the four economic criteria, viz., ownership of four-wheelers, telephones, immovable property and foreign travel in the previous year.

7. Voluntary disclosure scheme to tap black money for productive use.

8. Introduction of a new Estimated Income Scheme for retail traders having a total turnover of less than Rs. 40 lakhs in replacement of the existing presumptive scheme of taxation under section 115(K).

9. Withdrawal of the existing 7.5% surcharge on corporate tax.

10. Introduction of carry forward system in Minimum Alternate Tax (MAT) with full exemption of export profits.

11. Reduction in corporate tax rates for domestic companies to 35% and foreign companies to 48%.

12. Reduction in the tax rate payable by the corporate sector on royalty and technical services fees to foreign companies from 30% to 20%.

13. Reduction in the Capital Gains Tax payable by NRIs on securities to bring it on par with the rate applicable to FIIs (10%).

14. Abolition of the tax on dividends in the hands of the shareholders. Introduction of a new tax on distributed profits at the rate of 10% payable by the companies.

15. Increase in the deduction limit under section 80L to Rs.15,000 (applicable to income received from the units of UTI, approved mutual funds, government securities and interest on bank deposits).

16. Extension of tax holiday scheme u/s. 80-IA to Telecom.

17. Reduction in the interest tax levied on the interest income of financial institutions including banks and NBFCs from 3% to 2% with a promise to eliminate this tax eventually.

18. Amendment in Section 37 of the Income Tax Act to provide for the removal of artificial disallowances on account of advertisement expenditure, travelling, hotel expenses, entertainment expenses, etc. incurred for legitimate business purposes.

19. Significant reduction in customs duties on several items amounting to Rs.2625 crores in a financial year.

20. Reduction in the peak rate of customs from 50% to 40%.

21. Reduction in customs duty on baggage imports from 60% to 50%.

22. Reduction in customs duty on capital goods from 25% to 20% and the duty on project imports also reduced to 20%.

23. Significant reduction in customs duty on several inputs for steel industry, chemicals, textile machinery, medical equipment, computer equipment & software, special equipment for hotels catering to tourists, components of colour TV, telecom equipment, etc.

24. Rationalisation of excise rate structure with an objective of moving towards a mean rate of 18% with a four-rate structure by 1999.

25. Significant reduction in excise on items of mass consumption such as biscuits, sugar confectionery, tooth-paste, soaps, beverages like cocoa & coffee, low-priced watches, etc.

26. Reduction of 10% in excise duty on polyester filament yarn, cosmetics & toilet preparations and air-conditioners.

27. Increase in excise on cigarettes & bidis.

28. Simplification and concessions of excise duty for small-scale sector through the introduction of a flat duty rate of 3% ad valorem on clearances between Rs.30 to 50 lakhs and 5% on Rs.50 to 100 lakhs.

29. Extension of Service Tax to transportation of goods by road, consulting engineers, air-travel agents, tour operators, out-door caterers, man-power recruitment agencies, etc. to bring in additional revenue of Rs.1200 crores in a full year.

30. Increase in the prices of post cards, inland letters & envelopes.

31. Innovative schemes to tap resources for infrastructure financing; oil exploration and industrial parks to be treated as infrastructure.

Exhibit 2

Union Budget 1997-98 at a Glance

(Rs. crores)

		1992-93 Actuals	1993-94 Actuals	1994-95 Actuals	1995-96 Actuals	1996-97 BE	1996-97 RE	1997-98 BE
1	Tax Revenue	54044	53449	67454	81939	97310	97212	113394
2	Non Tax Revenue	20084	22004	23629	28191	33035	33571	39749
3	Revenue Receipts	74128	75453	91083	110130	130345	130783	153143
4	Loan Recoveries	6356	6191	6345	6505	7048	7809	8779
5	Other Receipts	1961	-48	5607	1397	5001	575	4800
6	Borrowing	27861	49297	56743	50436	55688	56231	65454
7	Capital Receipts	36178	55440	68695	58338	67737	64615	79033
8	Total Receipts	110306	130893	159778	168468	198082	195398	232176
9	Interest Payments	31035	36695	44049	50031	60000	58500	68000
10	Revenue Expenditure	92702	108169	122112	139860	161820	158988	183408
11	Capital Expenditure	29916	33684	38627	38415	42840	43310	48768
12	Total Expenditure	122618	141853	160739	178275	204660	202298	232176
13	Revenue Deficit	18574	32716	31029	29730	31475	28205	30266
14	Capital Surplus	6262	21756	30068	19843	24897	21305	NA
15	Budget Deficit	12312	10960	961	9807	6578	6900	NA
16	Fiscal Deficit (3+4+5-12)	40173	60257	57704	60243	62266	63131	65454
17	Primary Deficit (16-9)	9138	23562	13655	10212	2266	4631	(-)2546

NA = Not Applicable

Exhibit 3

Union Budget 1997-98 : Summary Of Receipts

(Rs. Crores)

	Item	1996-97 BE	1996-97 RE	1997-98 BE
I.	Tax Revenue			
	1. Corporation Tax	19600	19010	21860
	2. Income Tax	17843	18843	21700
	3. Interest Tax	1250	2000	1800
	4. Expenditure Tax	190	190	210
	5. Wealth Tax	110	110	130
	6. Customs Duties	44435	44135	52550
	7. Excise Duties	46884	46190	52200
	8. Service Tax	970	970	2150
	9. Other Taxes & Duties	863	871	1047
	10. Gross Tax Revenue	132145	132319	153647
	11. Share of States & UTs	34835	35107	40254
	12. Net Tax Revenue	97310	97212	113393
II.	Non-Tax Revenue			
	1. Interest Receipts	21393	21945	24092
	2. Dividends & Profits	4051	4077	6013
	3. External Grants	809	1199	1100
	4. Other Non-Tax Revenue	6782	6350	8545
	5. Total Non-Tax Revenue	33035	33571	39750
III.	Capital Receipts			
	1. Recoveries Of Loans	7048	7809	8779
	2. Market Borrowings	3700	4025	4070
	3. Other Short, Medium & Long Term Loans (including.Treasury Bills & Zero Coupon Bonds)	21798	21473	29750
	4. External Assistance	2461	2589	2435
	5. Disinvestment of Equity in Public Enterprises	5000	500	4800
	6. Small Savings, PPF and Staff PF	16250	17450	16550
	7. Special Deposits & Other Receipts	11480	10694	12649
	8. Total Capital Receipts	67737	64615	79033

Exhibit 4

Union Budget 1996-97 : Summary of Expenditure

(Rs. Crores)

No.	Item	1996-97 BE	1996-97 RE	1997-98 BE
1.	Non-Plan Expenditure			
	a) Interest Payments	60,000	58,500	68,000
	b) Food & Fertilizer Subsidies	14,716	14,233	17,130
	c) Other subsidies	1,604	2,461	1,121
	d) Write-off of Loans to States	330	301	212
	e) Defence Expenditure	27,798	29,498	35,620
	f) Pensions	4,509	5,095	5,251
	g) Social Services	3,189	3,401	3,461
	h) Economic Services	5,115	5,275	4,001
	i) Grants & Loans to States	17,468	17,088	16,366
	j) Grants & Loans to Foreign States	479	363	516
	k) Other Items	15,097	11,189	17,646
	Total Non-Plan Expenditure	149,975	147,404	169,324
2.	Plan Expenditure (4 + 5)	54,685	54,894	62,852
3.	Total Expenditure	204,660	202,298	232,176
4.	Central Assistance to State & UT Plans	21,972	24,790	26,722
5.	Budgetary Support for Central Plan	32,713	30,104	36,130
6.	Internal & Extra Budgetary Resources of Public Enterprises	54,373	47,414	55,709
7.	Total Central Plan Outlay (5 + 6)	87,086	77,518	91,839

Exhibit 5

Revenue & Fiscal Deficits of State Governments, Budget Estimates for 1996-97

(Rs. Crores)

No.	States	Conventional Surplus/Deficit	Revenue Surplus/Deficit	Gross Fiscal Surplus/Deficit
1.	Andhra Pradesh	-68.6	-320.1	-2096.6
2.	Arunachal Pradesh	4.6	283.3	-58.4
3.	Assam	31.7	271.0	-358.7
4.	Bihar	341.2	-481.3	-1261.3
5.	Goa	-9.5	7.9	-104.5
6.	Gujarat	-74.8	-197.8	-1664.3
7.	Haryana	-54.5	-148.4	-989.5
8.	Himachal Pradesh	-205.4	-373.8	-737.7
9.	Jammu & Kashmir	-351.8	412.1	-342.2
10.	Karnataka	47.3	-115.4	-1450.7
11.	Kerala	-585.5	-1034.7	-2003.0
12.	Madhya Pradesh	-131.8	-526.7	-1705.1
13.	Maharashtra	-497.3	-683.0	-4142.2
14.	Manipur	-13.1	112.7	-80.2
15.	Meghalaya	28.8	126.7	-50.3
16.	Mizoram	4.4	98.5	-41.6
17.	Nagaland	-18.3	59.7	-99.2
18.	Orissa	-75.6	-769.6	-1531.5
19.	Punjab	-383.1	-883.3	-1992.4
20.	Rajasthan	-139.1	-341.1	-2351.6
21.	Sikkim	-4.5	66.6	-47.0
22.	Tamil Nadu	-334.9	-1119.1	-2426.0
23.	Tripura	-52.4	66.8	-184.2
24.	Uttar Pradesh	-1665.9	-3739.3	-6602.3
25.	West Bengal	187.0	-1508.2	-3604.5
26.	NCT Delhi	-125.0	711.7	-572.5
Total (All States)		-4021.1	-10024.8	-36497.5

Source : Reserve Bank of India : *Report on Currency & Finance 1995-96*, Vol. II; February 1997.

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