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Macroeconomic Analysis of the Union Budget 1996-97

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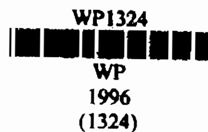

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Abstract

The Union Budget for 1996-97 was the maiden budget of the recently formed United Front Government. Given the political context and the economic scenario, the formulation of this budget was a fairly difficult task. An attempt has been made in this paper to present a broad macroeconomic analysis of the main proposals and provisions of the Union Budget 1996-97 in the context of the stated objectives of the budget 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 1996-97.

MACROECONOMIC ANALYSIS OF UNION BUDGET 1996-97

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1. Introduction

Union Budget for 1996-97 was the maiden budget presented by Mr. P. Chidambaram, widely acclaimed as the champion of economic reforms. If we compare the macroeconomic situation prevailing in July 1996 with what prevailed in July 1991 when Dr. Manmohan Singh presented his maiden budget, we find a sharp contrast. In July 1991, the country was passing through a severe economic crisis characterised by precarious foreign exchange reserve position, sharp deterioration in balance of payments, significant decline in GDP growth, large scale recession in the industrial sector, high rates of inflation and a major crisis of confidence with regard to the international financial markets. As against this, the overall macroeconomic outlook in July 1996 was quite healthy and favourable as indicated by an overall growth rate of 7%, industrial growth rate of around 12%, low rate of inflation of around 4.5%, buoyancy in exports, fairly comfortable level of foreign exchange reserves of more than 17 billion dollars and a reasonably positive outlook as far as foreign investment was concerned. This augured well for a professionally oriented finance minister willing to take bold initiatives and push the process of economic reforms forward at an accelerated pace. However, the crucial aspect affecting the exercise of budget formulation, that differed significantly between 1991 and 1996, was the one relating to the political compulsions facing the finance minister. While Dr. Manmohan Singh had a relatively free hand in pursuing the basic economic agenda, Mr. P. Chidambaram had to operate under the serious constraints imposed by a coalition government formed by 13 parties with explicit or implicit Leftist orientation. It was widely hoped that the Finance Minister would emerge successfully from this tight-rope walk and initiate the process of completion of the unfinished long pending agenda of economic reforms. These expectations were, however, belied by the budget for 1996-97, which unfortunately turned out to be a budget characterised more by postponements and promises than any concrete action aimed at producing tangible results.

The main objectives of the Budget, as stated explicitly by the Finance Minister in his Budget Speech, are as follows: (i) to continue the process of economic reforms for achieving accelerated economic growth; (ii) to strengthen focus on poverty alleviation through provision of basic minimum services; (iii) to achieve broad-based employment oriented growth in all sectors; (iv) to ensure fiscal prudence and macroeconomic stability; (v) to enhance investment in infrastructure; (vi) to strengthen human development effort; and (vii) to ensure viability in the balance of payments. Whatever measures have been announced in the budget are not at all commensurate with the magnitude and intensity of effort required to achieve such a

wide-ranging array of highly ambitious objectives. As a result, this budget appears to be long on words and short on action.

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 1996-97 aimed at achieving each of the above-mentioned objectives and the impact that these measures are likely to have on Indian economy during 1996-97. 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*.

2. Basic Minimum Services

The provision of basic minimum services constitutes an important ingredient of the United Front government's Common Minimum Programme. The specific areas covered in this context are : 100% coverage of provision for safe drinking water, primary health centres, universalisation of primary education, public housing for all shelterless poor families, extension of mid-day meal scheme, road connectivity to all villages and strengthening the public distribution system. In the budget, Rs. 2,466 crores are allocated for this purpose covering all States and UTs - which implies less than 100 crores per state for all seven schemes taken together. It is quite evident that this allocation is meagre and it is unlikely to create the kind of impact that is envisaged in the Common Minimum Programme. Moreover, such schemes, which are to be implemented by the respective state governments, usually have a very high incidence of leakages and, as a result, only a fraction of the actual public expenditure leads to tangible grassroot level benefits. However, what needs to be noted is that all other central assistance to states for all purposes is frozen at the 1995-96 level of Rs.19,800 crores, perhaps as a trade-off for this special allocation towards provision of basic minimum services. In effect, therefore, this implies only a 12% increase in the central assistance to states, which in itself does not represent any significant departure from the past trends, but the difference is that this expenditure would now have to provide for a significantly expanded coverage. What is surprising is that the Finance Minister has ignored the managerial aspects of these schemes. There is no mention about the institutional mechanisms for the delivery of these basic minimum services. Thus, this aspect of the budget is more like creating another avenue for ad hoc budgetary transfer of resources from the centre to the states, which was perhaps inevitable in the present political scenario with the regional parties dominating the coalition government at the centre.

In addition to this, several small cosmetic measures like establishment of Old Age Homes with the provision of a meagre sum of Rs. 5 crores, Residential primary schools for poor children (again Rs. 5 crores), National Illness Assistance Fund (also Rs.5 crores) and State Level Women Development Corporations (total allocation of only Rs.10 crores) have been announced in the budget. These measures are nothing but an eye-wash and, in view of the grossly inadequate budgetary provisions, they are likely to remain only on paper without creating any visible impact.

3. **Agricultural Development**

The specific measures to promote agricultural development announced in the budget are as follows :

a) Share capital of NABARD to be increased from Rs.500 crores to Rs.1000 crores this year and Rs.2000 crores within 5 years. However, actual budgetary provision for this purpose is only Rs.100 crores with the remaining Rs.400 crores coming from RBI. Thus, the bulk of the resources for this purpose is expected to be drawn from the RBI, which in a way is an innovative method of drawing resources from RBI without the same amount being treated as a component of the government borrowing and, hence, of the fiscal deficit.

b) Strengthening of Rural Infrastructure Development Fund (RIDF) for which an additional amount of Rs.2500 crores has been allocated for 1996-97, though it needs to be noted that no budgetary provision has been made for this expenditure in the present budget.

c) A new programme called Accelerated Irrigation Benefit Programme for timely completion of large irrigation projects of Rs.1,000 crores and above has been initiated in this budget. However, total budgetary allocation for this purpose is only Rs.800 crores. We can safely assume that each of the existing large projects would have remained incomplete mainly on account of cost and time over-runs amounting to 30% or more of the original project cost sanctioned for the respective projects. Thus, each project would require additional funds of the order of Rs. 300 crores or more which means that the budgetary allocation of Rs. 800 crores to take care of the needs of a number of such projects is grossly inadequate and it could even lead to serious problems of inter-state allocations at the time of actual disbursement.

d) The most surprising aspect of the package for agricultural development in this budget is the significant amount of direct cash subsidies targeted specifically for large farmers for financing the purchase of power tillers, tractors, sprinklers and drip irrigation equipment. This measure is particularly surprising because it is quite openly pro-rich and against the basic Leftist ideology. In fact, this measure clearly implies a bold trade-off between growth and social justice, where the former is preferred over the latter, as far as the agricultural sector is concerned. If the Leftist block in the coalition could feel comfortable with this measure, one wonders why the same stance is not adopted when it comes to the industrial sector, where a similar trade-off could actually produce far more significant results.

4. **Infrastructure Development**

A positive aspect of the budget is the thrust that it proposes to give to infrastructure development. Given the relatively inadequate performance of infrastructure sectors, especially power, coal, road transport and communication in the recent past, there is an urgent need to focus attention on this crucial sector. In fact, 7% growth rate achieved last year and targeted for the next year in the budget is not sustainable without substantial infrastructure development. In this context, establishment of Infrastructure Development Finance Company (IDFC) with authorised share capital

of Rs.5,000 crores is a welcome step. However, what is disappointing is that the actual budgetary provision for this purpose is only Rs.500 crores, which again implies that the balance amount of Rs.4,500 crores would have to be raised from other domestic resources and to that extent this additional demand for resources would compete with similar demands from other sectors resulting in some kind of an overall resource crunch in the economy at a later stage.

The provision made in the budget for modifying the existing guidelines to facilitate the introduction of long term financial instruments of 15 to 20 years duration is also a welcome measure, as it would increase the flexibility for raising resources for the long gestation projects characterising the infrastructure sector. However, it is rather disappointing that the specific demand of financial institutions to give special treatment to long maturing deep discount bonds for tax purposes has not been granted. To that extent, this provision is unlikely to create any major impact with regard to financing the infrastructure projects. Another welcome measure in the budget is the provision of Rs.200 crores to strengthen the capital base of National Highway Authority. However, as in the case of other provisions, this amount is also highly inadequate in the light of the enormous requirement for construction of new highways and extension as well as maintenance of existing highways in different parts of this vast country.

A welcome provision made in the budget for mobilising resources for financing infrastructure projects relates to the tax concessions granted to the special funds established for this purpose. The funds established for financing infrastructure facilities have been fully exempted from income tax and any dividend, interest or long term capital gains of such funds or companies from investments in the form of shares or long term finance in any enterprise set up to develop, maintain and operate an infrastructure facility have also been exempted from income tax.

By and large the measures for infrastructure development represent the best part of the budget. However, it needs to be emphasised in this context that such initiatives can only fulfil some of the necessary conditions for infrastructure development. What is urgently required in addition to such measures especially from the viewpoint of attracting private investment or foreign direct investment in the form of infrastructure projects is a combination of clarity, transparency and expediency in evolving and implementing appropriate policy guidelines for processing specific investment proposals for sectors such as power, telecom, mining, roads, etc. In fact, in the updated version of the Economic Survey, the finance ministry has clearly recognized that, in the field of infrastructure development, "much remains to be done to develop and implement viable policy frameworks and institutional structures". Moreover, "independent regulatory authorities have to be established to set appropriate rates, harmonise design standards & specifications and generally promote the public interest" and "transparent and workable rules and procedures for private investment and operation have to be clearly set out in each infrastructure sector". Thus, while the basic underlying issues seem to have been well recognized by the finance ministry, it is rather disappointing that no concrete action in this direction has been proposed in this budget.

5. Economic Reforms

While the Finance Minister has explicitly stated that there is a need to continue the process of economic reforms, he has done precious little in the budget in this direction. Dr. Manmohan Singh had outlined the agenda for further reforms while presenting the interim budget in February 1996. The need for continuing economic reforms was also stressed in the Common Minimum Programme of the new government. It, therefore, seemed that there was a fair amount of consensus on the need for urgent reforms required in insurance sector, financial sector, capital market, public enterprises, control of public expenditure, the system of indirect taxes, especially the customs and the excise duties, and the system of direct taxes, especially the corporate tax.

It is highly disappointing to find that all of these reforms without exception have been postponed. The present budget pays only lip-service to these long pending reforms. Thus, what we find in the budget are the following kind of announcements : High level expenditure management and reforms commission to be set up, discussion paper on subsidies to be prepared, phasing out ad hoc treasury bill system to be taken up later (next year or thereafter), foreign investment promotion council to be set up in future, independent tariff commission to be set up in future, disinvestment commission to be established, new Companies Act to be introduced in the winter session, excise reform to be undertaken in future, significant part of custom reform also to be undertaken in future, insurance sector reforms postponed to next year, and finally complete withdrawal of surcharge on the corporate tax is also deferred to the next year. In fact, there are quite a few provisions in the budget such as levy of special customs duty of 2% on all dutiable items, introduction of Minimum Alternative Tax (MAT) on zero-tax companies, massive increase in subsidies, etc., which actually amount to some kind of a reversal of the corresponding reforms already carried out earlier. Such measures clearly represent retrograde steps which for all practical purposes amount to the government taking one step forward and two steps backward.

6. Fiscal Deficit

The Finance Minister has claimed considerable success in reducing the fiscal deficit in absolute as well as relative terms. Thus, according to the budget calculations, the fiscal deficit for the year 1996-97 is placed at Rs.62.3 thousand crores or 5% of GDP, which is significantly lower than the corresponding figure of Rs.64 thousand crores indicating 5.9% of GDP for the previous year. However, it would be some sort of a miracle if the actual magnitude of fiscal deficit during 1996-97 could be contained within the budgeted limit of Rs.62.3 thousand crores. If we carefully examine the finance ministry's calculations as reflected in the detailed budget documents, we find that revenues from indirect taxes have been somewhat over-estimated and expenditures on several counts have been seriously under-estimated to arrive at this artificially low figure of fiscal deficit.

Comparative growth rates of revenue from Customs & Excise duties observed in 1995-96 and budgeted for 1996-97 are shown in *Table 1*. While the revised estimates of the revenue from customs duties show an increase of almost 34% during 1995-96 as against the growth rate of 17% implicit in the budget estimates, it should be noted that a significant proportion of this buoyancy has resulted from the depreciation of rupee after July 1995. Our calculations indicate that the actual growth in customs revenue would have been only around 20%, if the exchange rate had

remained steady throughout the year. The relatively high growth rate of customs revenue provided in the budget for 1996-97 needs to be evaluated in this context. Thus, even if the overall volume growth of imports during 1996-97 remains as high as in 1995-96 (27%), the growth rate of customs revenue is unlikely to exceed 20% unless there is a further significant depreciation of the rupee during the year.

Table 1
Comparative Growth Rates of Revenue from Customs & Excise Duties

Year	Customs Duties	Excise Duties
1995-96		
Budget Estimates	17.1%	16.6%
Revised Estimates	33.7% (20.3%)*	11.1%
1996-97		
Budget Estimates	50.6%	9.6%
96-97 BE over 95-96 RE	25.7%	14.4%

* indicates the growth rate that might have been observed had there been no change in the exchange rate of the rupee during 1995-96.

The budget estimates of public expenditure for the year 1996-97 can be assessed in the light of the actual experience of 1995-96 in this regard. *Table 2* presents a comparison of the budgeted and the revised growth rates of revenue & capital expenditure during 1995-96 at current prices as well as at constant prices.

Table 2
Comparison of Budgeted & Revised Growth Rates of Public Expenditure during 1995-96

Category of Expenditure	1995-96 BE	1995-96 RE	Difference
Revenue Expenditure Excluding Interest at current prices	8.0%	17.2%	9.2%
Capital Expenditure at current prices	-7.3%	2.2%	9.4%
Revenue Expenditure Excluding Interest at constant prices	0.0%	12.8%	12.8%
Capital Expenditure at constant prices	-15.3%	-2.2%	13.1%

Note : The inflation rate assumed in the budget for 1995-96 was 8%, while the actual inflation rate, as indicated in the updated version of Economic Survey 1995-96, has turned out to be 4.4%.

It is evident from the figures given in Table 2 that the revised estimates of revenue expenditure excluding interest as well as capital expenditure exceeded the corresponding budget estimates by more than 9% in nominal terms and around 13% in real terms. It is interesting to observe in this context that the post-budget increase in the non-plan non-interest revenue expenditure accounts for more than two-thirds of the post-budget increase in total expenditure during 1995-96, although the share of this component in total expenditure is less than one-third. This clearly indicates the failure on the part of the Central Government to control the relatively more discretionary and ad hoc elements of public expenditure.

Since the political factors operating in 1996-97 are not likely to bring about any significant improvement with regard to the slippages in public expenditure, one could assume that the year 1996-97 would be marked by a similar degree of slippages in the non-interest revenue expenditure and capital expenditure (measured in real terms) as observed during 1995-96. Our estimates of the expected levels of public expenditure and fiscal deficit during 1996-97, based on this assumption, are presented in *Table 3*.

Table 3

Expected Levels of Public Expenditure & Fiscal Deficit during 1996-97

(Rs. 000 crores)

Category of Expenditure	1996-97 Budget Estimates	1996-97 Expected Level
Revenue Expenditure Excluding Interest	101,820	113,552
Interest Payments	60,000	60,000
Capital Expenditure	42,840	48,032
Total Expenditure	204,660	221,584
Fiscal Deficit	62,266	79,190

As the estimates given in Table 3 indicate, the likely magnitude of fiscal deficit during 1996-97 could be as high as 79 thousand crores, which would represent 6.3% of GDP, as against the corresponding budgeted level of 62 thousand crores representing 5% of GDP. Thus, according to our estimates, the situation with regard to fiscal deficit is likely to worsen rather than improve during 1996-97, which in turn would have serious implications on the government's ability to control inflation. It is evident that failure on this front would jeopardise the prospects of maintaining macroeconomic stability, especially as reflected by steady and smooth functioning of money markets, capital market and foreign exchange market.

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7. **Post-Budget Macroeconomic Scenario for 1996-97**

As already noted earlier, the macroeconomic situation was fairly comfortable during the year 1995-96, which was characterised by accelerated growth with relative price stability. Thus, the growth rate of GDP accelerated to 7% and the growth rate of industrial production increased to 12.4%, while the resurgence of inflationary pressure experienced in 1994-95 was reversed in 1995-96 as indicated by a sharp decline in the overall inflation rate (based on WPI) from 10.4% to 4.4%. According to the Finance Ministry, the success in reducing inflation is attributable to a combination of factors such as (a) the deceleration on monetary growth from 22.3% in 1994-95 to 13% in 1995-96; (b) high levels of open market sales of foodgrains which reduced the public food stocks from the record level of 35.6 million tonnes in July 1995 to 22.7 million tonnes by April 1996; (c) a liberal import policy for essential commodities; (d) the surge in domestic supply associated with accelerated economic growth; and (e) the delay in adjustment of administered prices. It should, however, be noted that the consumer price index for industrial workers showed an increase of 8.9% during 1995-96 showing only a marginal decline from the rate of 9.7% observed in 1994-95, which actually indicates an unusually wide divergence between the growth rates of WPI and CPI.

Major negative aspects of the macroeconomic situation in 1995-96 were : (a) a significant increase in the trade deficit from $ 2.4 billion in 1994-95 to $ 4.6 billion in 1995-96 mainly on account of the failure to accelerate the growth of exports; (b) a significant decline in the foreign exchange reserves from $ 20.8 billion in March 1995 to $ 17 billion in March 1996 mainly on account of the failure to attract the required levels of foreign investments; (c) unprecedented turbulence in the money market and the foreign exchange market during September-December 1995 with call money rates fluctuating widely in the range of 14% to 140% and the dollar exchange rate fluctuating in the range of $ 1 = Rs.34 to $ 1 = Rs.38; (d) significant resource crunch faced by the industrial sector mainly on account of the decline in the growth rate of bank credit to the commercial sector from 23% in 1994-95 to less than 16% in 1995-96, which was compounded by a decline in other sources of finance to industry such as capital raised through the primary market issues (decline of 24%) and significantly reduced inflows through GDR issues in Euro markets; and (e) significant increase in the real rates of interest resulting from high nominal rates of interest caused by continuation of the high levels of government borrowing associated with a large fiscal deficit in the face of an unusually restrictive credit policy.

It is in the context of this background that we should examine the post-budget macroeconomic scenario for Indian economy for the year 1996-97 emerging from our analysis of the Union Budget coupled with the recent macroeconomic trends. As indicated during the conventional post-budget briefing by the senior officials of the finance ministry on July 23, 1996, the budget is based on the target of 7% growth of GDP and around 6% to 7% rate of inflation during 1996-97. However, as already noted earlier, the fiscal deficit is likely to be much higher than budgeted and, hence, the overall rate of inflation is likely to be around 9% to 10%.

The major constraint in realising the overall growth target of 7% would be the availability of investible resources. Since the incremental capital output ratio observed during the VIII Plan period is around 4, the required rate of aggregate investment to achieve an overall 7% growth target would be around 28% of GDP. As the gross domestic saving rate is currently around 24%, it is unlikely to exceed 25% in

1996-97. In fact, the budget does not contain any generalised incentive for promoting household savings and whatever limited measures have been announced in the budget in this direction (such as marginal tax benefits on investment in infrastructure companies or enhanced limit for repayments of house building loans qualifying under Section 88, the overall ceiling for which has remained unchanged) are unlikely to have any significant impact on the overall savings rate. Hence, the overall gross domestic savings rate is most likely to be in the range of 24% to 25% of GDP during 1996-97.

Thus, a minimum resource gap of 3% of GDP, which could also turn out to be 4% of GDP, needs to be bridged for achieving the overall growth target. Since 3% of GDP for 1996-97 would roughly work out to $ 10 billion at the prevailing exchange rate of $ 1 = Rs. 35, the finance minister has conveniently fixed the target of foreign investment in the year 1996-97 at $ 10 billion. The target of 10 billion dollars of foreign investment implies more than tripling of foreign investment flows in Indian economy within a single year, as the actual inflow of foreign investment from various sources such as portfolio investment and foreign direct investment including GDR issues did not exceed $ 3 billion in 1995-96. The relevant question is whether such a quantum jump in foreign investment can be achieved during 1996-97, given the kind of budget that has been presented and the macroeconomic environment that is likely to emerge.

It seems that the finance ministry has conveniently assumed portfolio investment flows of around 6 billion dollars, on the basis of the tentative estimates of the actual inflows of about $ 1 billion recorded during the first quarter of 1996-97. However, since the budget did not contain any explicitly targeted measures for boosting the stock market, the post-budget behaviour of the stock market has been quite depressing and the market seems to have got into a bearish phase as indicated by the performance indicators of the Bombay Stock Exchange and the National Stock Exchange (*Table 4*).

Table 4
Post-Budget Behaviour of BSE & NSE Indices

Period	BSE Sensex	NSE Index
Pre-budget closing (July 22, 1996)	3797	1126
Two weeks after the budget (August 5, 1996)	3483	1032
Extent of fall	314 (8.3%)	94 (8.3%)

The post-budget decline in the country's major stock exchanges is attributable to several factors such as introduction of Minimum Alternative Tax (MAT) resulting in a significant erosion of the earnings per share of several blue chip companies, across the board increase in customs duty resulting in increased cost, negative reaction of FIIs to the idea of issuing non-voting shares, etc. A detailed study on the impact of MAT on corporate tax liability carried out by CMIE shows that in the year 1995-96 there were 2178 zero-tax companies among the profit making companies and in the category of tax paying companies there were 839 companies whose overall corporate tax incidence was less than 12.9%. Total additional tax liability arising on account

of MAT for these two categories of companies has been estimated at Rs.1710 crores and Rs.915 crores, respectively. Moreover, it has also been found that about 80% of MAT would be paid by the top 300 companies. It is evident, therefore, that imposition of MAT would have a deep and lasting impact on corporate profitability and it would affect many companies whose scrips are traded actively on the country's major stock exchanges.

Thus, given the post-budget scenario for the capital market, it is quite unlikely that during the remaining three quarters of 1996-97 additional net purchases of the order of 5 billion dollars would be made by the FIIs. In our opinion, the actual inflows of portfolio investment during 1996-97 would not exceed $ 3 billion, which in turn implies that foreign direct investment inflows will have to be as high as 7 billion dollars as against the actual inflows of $ 1 billion observed during 1995-96. This is obviously a tall order and it is evident that the overall target of 10 billion dollars of foreign investment inflows will end up with a considerable shortfall.

An analysis of recent trends in the growth of exports and imports indicates that the situation is likely to be equally uncomfortable with regard to the behaviour of trade deficit. The experience of 1994-95 & 1995-96 shows that the growth of imports is generally sluggish during the first quarter and it picks up considerably during the remaining three quarters. As against this, the growth of exports was more or less uniform across the first quarter and the remaining three quarters of 1995-96. One of the factors influencing the overall growth of imports during 1996-97 would be the relatively high international prices of crude oil that prevailed during the first quarter and may persist during the second quarter and perhaps even thereafter. Since oil imports currently account for about 20% of our total import bill, the behaviour of international oil price would significantly affect the growth rate of our imports. Moreover, if the high growth rate of industrial production is to be sustained, the growth of non-oil imports during the remaining three quarters will have to be significantly higher than what has been observed during the first quarter.

We can construct two alternative scenarios for forecasting trade deficit during 1996-97. The optimistic scenario is based on the assumption that both the aggregate imports as well as exports during the period July 1996 to March 1997 would grow at more or less the same rate as observed during the corresponding period in the preceding year (i.e., exports at 20% and imports at 30%). This scenario is considered optimistic because the significant depreciation of the rupee during the post-July 1995 period helped in sustaining the tempo of export growth and simultaneously curbing at least partially the growth potential of imports during the last three quarters of 1995-96. The pessimistic scenario is based on the assumption that the growth rate of exports observed during the first quarter would continue during the post-July period as well, while the growth rate of imports would marginally increase to 35% during the same period. This assumption essentially implies continuation of the inter-quarter growth pattern of imports and exports observed during 1995-96. Our forecast of trade deficit in the context of the recent trends in India's foreign trade is presented in *Table 5*. As shown in this table, the likely magnitude of trade deficit under the optimistic scenario would be $ 8.3 billion (2.4% of GDP) and $ 11.0 billion (3.2% of GDP) under the pessimistic scenario, as against the actual level of $ 4.6 billion

(1.5% of GDP) observed in 1995-96. Thus, in our view, the year 1996-97 would be characterised by a significant increase in the trade deficit implying the corresponding increase in the requirement of foreign exchange resources to finance this rapidly growing trade gap.

Table 5

Recent Trends in Trade Deficit and Forecast for 1996-97

(US $ Billion)

Period	Exports	Imports	Trade Deficit
1994-95			
April-June	6.0	6.5	0.5
July-March	20.3	22.2	1.9
Total for 1994-95	26.3	28.7	2.4
1995-96			
April-June	7.2	8.0	0.8
July-March	24.6	28.4	3.8
Total for 1995-96	31.8	36.4	4.6
1996-97			
April-June *(Provisional Estimates)*	8.2	9.1	0.9
Optimistic Scenario			
July-March	29.5	36.9	7.4
Total for 1996-97	37.7	46.0	8.3
Pessimistic Scenario			
July-March	28.2	38.3	10.1
Total for 1996-97	36.4	47.4	11.0

The main implication of the above analysis and forecast of fiscal deficit, foreign investment and trade deficit is that the objective of sustaining a high rate of growth and simultaneously maintaining macroeconomic stability during 1996-97 could prove to be elusive. Mounting inflationary pressures coupled with a sizeable resource crunch would adversely affect short-term interest rates, exchange rate and overall growth prospects for the industrial sector. These circumstances could present an uncomfortable trade off between growth and macroeconomic stability and it is rather difficult to hazard a guess at this juncture as to how the government would respond to the emerging macroeconomic scenario under such conditions.

Our forecast of the overall post-budget macroeconomic scenario for 1996-97 is presented in *Table 6*. While some aspects of this forecast are moderately optimistic, it is evident that we do not share the high degree of optimism implicit in the finance ministry's projections. Thus, in our view, both the GDP growth as well as the industrial growth would be lower while the inflation rate would be higher during 1996-97. Moreover, the fiscal deficit as well as the current account deficit would increase significantly and the exchange rate as well as the foreign exchange reserves would be under considerable pressure. These developments coupled with the growing competition in the domestic market could exert a significant pressure on the corporate profitability during 1996-97.

Table 6
Post-Budget Macroeconomic Forecast for 1996-97

Macroeconomic Variable	Finance Ministry's Projection	Our Forecast
GDP Growth	7%	5.5% to 6%
Industrial Growth	12%	9% to 10%
Inflation Rate	6% to 7%	9%
Fiscal Deficit	5% of GDP	6.3% of GDP
Export Growth	20%	17%
Import Growth	20% to 25%	30%
Current Account Deficit	1.5% to 2% of GDP	2.5% to 3% of GDP
Foreign Investment	$ 10 billion	$ 5 billion
Exchange Rate (March 1997)	N.A.	$ 1 = Rs.37
Forex Reserves (March 1997)	N.A.	$ 16 billion

Exhibit 1

Main Provisions of Union Budget 1996-97

1. Significant reduction in fiscal deficit from 5.9% of GDP in 1995-96 to 5% of GDP in 1996-97.

2. Uncovered budget deficit to be reduced from Rs.7600 crores in 1995-96 (revised estimates) to Rs.6578 crores in 1996-97.

3. Significant increase in food & fertilizer subsidy.
   Introduction of new subsidies for power tillers, tractors and sprinklers.

4. Income-tax rate reduced from 20% to 15% for the first slab and Standard Deduction increased from Rs.15,000 to Rs.18,000 for the salaried class.

5. Surcharge on corporate tax reduced from 15% to 7.5%

6. Minimum Alternate Tax (MAT) on zero-tax companies introduced under which a minimum of 30% of the book profit would be taxable. At the current tax rate, the effective tax rate for the zero-tax companies will work out at 12.9% of the book profit. Companies engaged in power & infrastructure sectors and 100% EOUs will be exempted from MAT. This measure is expected to yield additional tax revenue of Rs.2000 crores.

7. Two new schemes to provide incentives for specific forms of savings introduced : (a) Contribution upto Rs.10,000 per annum to new LIC personal-cum-family pension scheme "*Jeevan Suraksha*" be eligible for deduction from taxable income; and (b) investment in public issues aimed at creating new infrastructure facilities or power generation will qualify for an enhanced limit of Rs.70,000 (instead of the existing limit of Rs.60,000) under Section 88.

8. Five-year tax holiday under Section 80-IA extended to investment in irrigation, water supply, sanitation and sewerage systems.

9. Dividend, interest or long term capital gains of infrastructure financing funds fully exempt from income tax.

10. Establishment of Infrastructure Finance Development Company (IDFC) to mobilise resources for long term finance.

11. Proposal to set up state level agricultural finance institutions and new private local area banks.

12. Significant increase in the share capital of NABARD and additional allocation for Rural Infrastructure Development Fund (RIDF).

13. Introduction of accelerated irrigation benefit programme to accelerate completion of large irrigation projects.

14. Corporate sector allowed to issue non-voting shares of upto 25% of issued share capital.

15. Ceiling on individual FII investment increased from 5% to 10%, subject to the aggregate limit of 24% for all FIIs taken together.

16. Limit on lumpsum royalty payment for automatic approval of technology imports increased from Rs.1 crore to Rs.7 crores.

17. Announcement regarding establishment of several commissions such as Expenditure Management & Reforms Commission, Tariff Commission, Divestment Commission, etc.

18. A special customs duty of 2% on all imports except those which carry *nil* rate to net Rs.1,600 crores.

19. Reduction in customs duty on several specific items such as metals, crude oil, basic petrochemical intermediates, electronic goods, telecommunication equipments, edible oils, plastics, non-coking coal, etc.

20. Reduction in excise duty on several items such as toothpaste, detergents, cartons, boxes, glassware, ceramic articles, etc.

21. Excise duty on petroleum products and cigarettes raised.

22. All tax proposals taken together expected to yield additional revenue of Rs.2622 crores in 1996-97 (Rs.3500 crores in a full year).

23. Recapitalisation needs for public sector banks fixed at Rs.909 crores for the financial year 1996-97. A provision of Rs.200 crores made for recapitalising RRBs. Reconstruction Bank of India to be converted into a fulfledged, all purpose development finance institution.

Exhibit 2

Union Budget 1996-97 at a Glance

(Rs. crores)

		1992-93 Actuals	1993-94 Actuals	1994-95 Actuals	1995-96 BE	1995-96 RE	1996-97 BE
1	Tax Revenue	54044	53449	67454	74374	81088	97310
2	Non Tax Revenue	20084	22004	23629	26413	29103	33035
3	Revenue Receipts	74128	75453	91083	100787	110191	130345
4	Loan Recoveries	6356	6191	6345	6730	7411	7048
5	Other Receipts	1961	-48	5607	7000	1392	5001
6	Borrowing	27861	49297	56743	52634	56410	55688
7	Capital Receipts	36178	55440	68695	66364	65213	67737
8	Total Receipts	110306	130893	159778	167151	175404	198082
9	Interest Payments	31035	36695	44049	52000	52000	60000
10	Revenue Expenditure	92702	108169	122112	136328	143522	161820
11	Capital Expenditure	29916	33684	38627	35823	39482	42840
12	Total Expenditure	122618	141853	160739	172151	183004	204660
13	Revenue Deficit	18574	32716	31029	35541	33331	31475
14	Capital Surplus	6262	21756	30068	30541	25731	24897
15	Budget Deficit	12312	10960	961	5000	7600	6578
16	Fiscal Deficit (3+4+5-12)	40173	60257	57704	57634	64010	62266
17	Primary Deficit (16-9)	9138	23562	13655	5634	12010	2266

Exhibit 3				
Union Budget 1996-97 : Summary Of Receipts (Rs. Crores)				
	Item	1995-96 BE	1995-96 RE	1996-97 BE
I.	Tax Revenue			
	1. Corporation Tax	15500	16250	19600
	2. Income Tax	13500	15100	17843
	3. Interest Tax	1000	900	1250
	4. Expenditure Tax	175	175	190
	5. Wealth Tax	90	90	110
	6. Custom Duties	29500	35352	44435
	7. Excise Duties	42780	41000	46884
	8. Other Taxes & Duties	1217	1487	1833
	9. Gross Tax Revenue	103762	110354	132145
	10. Share of States & UTs	29388	29266	34835
	11. Net Tax Revenue	74374	81088	97310
II.	Non-Tax Revenue			
	1. Interest Receipts	18419	18369	21393
	2. Dividends & Profits	2946	3229	4051
	3. External Grants	1154	1207	809
	4. Other Non-Tax Revenue	3894	6298	6782
	5. Total Non-Tax Revenue	26413	29103	33035
III.	Capital Receipts			
	1. Recoveries Of Loans	6730	7411	7048
	2. Market Borrowings	3700	3700	3700
	3. Other Short, Medium & Long Term Loans (including Treasury Bills & Zero Coupon Bonds)	23387	23800	21798
	4. External Assistance	4456	1969	2461
	5. Disinvestment of Equity in Public Enterprises	7000	357	5000
	6. Small Savings, PPF and Staff PF	10000	15650	16250
	7. Special Deposits & Other Receipts	11091	12326	11480
	8. Total Capital Receipts	66364	65213	67737

Exhibit 4
Union Budget 1996-97 : Summary of Expenditure

(Rs. Crores)

No.	Item	1995-96 BE	1995-96 RE	1996-97 BE
1.	Non-Plan Expenditure			
	a) Interest Payments	52,000	52,000	60,000
	b) Food & Fertilizer Subsidies	10,965	12,050	14,716
	c) Other subsidies	1,436	1,676	1,604
	d) Write-off of Loans to States	200	1,010	330
	e) Defence Expenditure	25,500	26,879	27,798
	f) Pensions	3,851	4,295	4,509
	g) Social Services	2,750	3,345	3,189
	h) Economic Services	3,720	5,032	5,115
	i) Grants & Loans to States	13,089	16,489	17,468
	j) Grants & Loans to Foreign States	305	379	479
	k) Other Items	10,035	12,175	15,097
	Total Non-Plan Expenditure	123,651	134,320	149,975
2.	Plan Expenditure (4 + 5)	48,500	48,684	54,685
3.	Total Expenditure	172,151	183,004	204,660
4.	Central Assistance to State & UT Plans	19,506	19,854	21,972
5.	Budgetary Support for Central Plan	28,994	28,830	32,713
6.	Internal & Extra Budgetary Resources of Public Enterprises	49,855	45,764	54,373
7.	Total Central Plan Outlay (5 + 6)	78,849	74,594	87,086

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