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UNION BUDGET 2007-08: AN ANALYSIS

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This article reviews and analyses the Union Budget 2007-08. The Budget, which is further committed to strengthening the path of fiscal consolidation in 2007-2008, stipulates the Fiscal Responsibility and Budget Management Act (FRBMA), and the continued strategy of revenue-led correction along with desired allocation of expenditure. The Budget estimates a primary surplus for 2007-08. It also analyses as to how the growth momentum of the economy can be maintained by easing infrastructural bottlenecks and reviving a sagging agricultural sector. The high priority status accorded to education and agriculture in the budget speech is not backed by numbers. The situation demands an increase in public expenditure (particularly capital expenditure) relative to GDP.

The Budget embodies the socio-political and economic policy priorities and the fiscal targets of the government. The government's economic policy cannot ignore political compulsions. This Budget, which was announced just before the beginning of the Eleventh Five- Year Plan (2007-2012), is supposed to give a clear direction in which the economy should move. The Budget addresses a number of objectives: (i) to maintain the growth momentum; (ii) to fulfill the mandate of the National Common Minimum Programme (NCMP) of the United Progressive Alliance (UPA) government, (iii) to adhere to the fiscal discipline as stipulated in the Fiscal Responsibility and Budget Management Act (FRBMA); and (iv) to meet competing claims for resources while maintaining fiscal discipline requires the union finance minister to undertake a tightrope walk not only in allocating resources but also making a trade off between short and medium-term objectives (M. Govinda Rao, 2007).

I- Robust Macro Economic Variables

The Union Budget 2007-08 was presented in the background of a buoyant economy with sound economic fundamentals such as (a) a blistering pace of a growth rate of over 9 per cent in the past two years, preceded by an average growth of 8.6 per cent for three years of the UPA Government; (b) the nation having been spellbound by the numbers that wove a magical story. Manufacturing grew at 11 per cent during 2006-

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07, up from 8.7 per cent and 9.1 per cent in the last two years respectively; (c) an increase in the per capita income by 7.4 per cent in 2005-06; (d) the spurt in savings and investment at 32.4 per cent and 33.8 per cent respectively; (e) the robust revenues for the government for the third year running; and (f) a fiscal deficit reduction never achieved before. No doubt, before the Budget was implemented, the economy had made impressive gains. Services achieved a new high, bank credit recorded a jump, the growth rate of foreign trade was twice that of GDP, there had been a spectacular rise in foreign direct investment for several years, and lakhs of school-teachers were being appointed. One of the best things about the current growth rate is that it is driven by investment rather than consumption. But, if the Tenth Five-Year Plan period (2002-07) saw an average growth rate of 7.6 per cent, it was in no small measure due to the realisation that private-public partnerships in infrastructure building would have to show the way.

In the last two years, the Government of India has been basking in the glow of an unprecedented growth. The Budget makes it a point to emphasise that such high growth rates are necessary to address the problems of poverty, malnutrition, illiteracy, and ill health. Now, the way to make the growth more inclusive is to pay more attention to agriculture and rural infrastructure and to raise the incomes of the rural population that has been hit by the poor performance of the farm sector. Unexceptionable as the diagnosis and the sentiment are, the efforts in the Budget clearly fall short of the rhetoric. There is so much to build on. The Budget does not contain much evidence of delivering on the Government's commitments to economic reforms, casting an eye over the other side of the report card: sluggish agriculture, lack of irrigation and infrastructure, low social sector indices, shortage of basic and technical education, etc.

II- Area of Concern: inflation

The Budget has a clear focus to curb the price rise, increase public spending on education and health, and revitalise agriculture. The stock position of wheat and oilseeds commodities is low. In the case of wheat, the buffer stock is such that it may run out soon unless there is a substantial procurement during this fiscal year. But, the peak of the marketing season comes in April, and the moving of the stocks to the distribution system takes time. There is also a serious deficit developing in oilseeds supply, and the efforts for the imports of oilseeds need to be made without delay. It is the food prices that will set the psychological

tone for inflation despite their low weightage in the Wholesale Price Index (WPI).

Keeping the rate of inflation under check is looking difficult because it has strong monetary roots laced with supply side pressures. The rate of growth of broad money supply is now more than 21 per cent. Even accounting for 9 per cent GDP growth rate, there is a gap of about 12 percentage points. As the inflation rate is about 5 per cent, there is still a latent inflationary pressure of 5 or 7 percentage points. The inflation rate in the case of food and essential products and some infrastructure items is now touching 10 per cent. Consequently, there is also a build-up of inflationary expectations. Inflation in food items has been allowed to go out of hand quite unnecessarily. With a proper information system and timely predictions for essential food items, it should have been possible to import in time and even out these supply-side imbalances. There are, however, some fiscal measures in the Budget to reduce the inflationary pressure from the cost side, particularly the reduction in the peak Customs duty rates to 10 per cent and a reduction in the ad valorem component of the excise duty on petroleum.

The Budget was not used as the main instrument of inflation control. The curbing of inflation is important, but the major initiative for this has to come from the monetary sector and supply side. One myth is that our high growth is causing the economy to overheat and prices are not caused by high growth but by the economy's urge to grow even faster without having the wherewithal for that. With the Indian economy growing unexpectedly rapidly over the last four years, all excess capacity in human and physical capital has disappeared and our entrepreneurs have been caught by surprise without enough investment to respond to this higher demand. The rise in investment that we are seeing now should dampen the inflationary urge for some more months. The government's immediate response should be to boost the supply of essential commodities and to curb the increase of money supply. Answer to inflation may lie in supply management – especially an increase of production of agricultural products and, if necessary, supplemented by imports from the international markets.

III- Public Revenue: taxation

For the first time during the past few years, the actual collections in direct and indirect taxes have exceeded both the Budget estimates and the revised estimates. For fiscal year 2006-07, the direct tax collection

was at Rs. 2,29,181 crore and indirect tax collection was at Rs. 2,40,896 crore. In the case of direct taxes, the Budget estimate was pegged at Rs. 2,10,419 crore, but later revised upwards to Rs. 2,29,007 crore. In the case od indirect taxes, the Budget estimate was pegged at Rs. 2,29,533 crore and later revised upwards to Rs. 2,36,202 crore. A higher GDP growth, better compliance and better tax administration were the main factors behind this strong revenue collection performance. The data also validate the shift away from indirect taxes to direct taxes in the post-reform period, with the share of direct taxes in gross tax revenues of the Centre touching 48.8 per cent in 2006-07. In 1990-91, less than a fifth of Centre's gross tax revenues came from direct taxes. The service tax collection of Rs. 37,352 crore in 2006-07 is lower than the revised estimate of Rs. 38,169 crore, but higher than the Budget estimate of Rs. 34,500 crore.

TOPPING TARGET

(Rs. crore)

	Budget estimates	**Revised estimate**	**Actual estimate**
Customs	77,066	81,800	86,294
Central excise	1,17,967	1,16,233	1,17,250
Service tax	34,500	38,169	37,352
Total indirect taxes	2,29,533	2,36,202	2,40,896
Corporation tax	1,33,010	1,46,497	1,43,561
Personal income tax (includes FBT, STT, BCTT)	77,409	82,510	85,620
Total direct taxes	2,10,419	2,29,007	2,29,181

Source: The Hindu Business Line, April 25, 2007

Service Tax: Though less controversial than FBT(fringe benefit tax), the service tax suffers from serious shortcomings. No rational basis exists for its selective levy and unjustified discrimination. For instance, there is no logical reason why services provided by doctors and lawyers remain outside the purview of this tax. The extension of the service tax to a few areas such as commercial renting, and the fringe benefit tax to employee stock options while keeping the rates unchanged is something that industry can live with.

The education cess goes up from 2 to 3 per cent, which is intended to boost secondary and higher education. The excise duty on petrol and

diesel is down, but it may not lead to an immediate cut in the fuel prices. At best, it is a middle-of-the-road, benign budget. The peak tariffs have been reduced from 12.5 per cent to 10 per cent, even then they are above the targeted ASEAN (Association of South-East Nations) levels. Instead of reducing customs duty to the ASEAN level of 8 per cent, the budget has cut peak customs duty to only 10 per cent, though duties on some items (notably fibres and plastics) have been cut to 7.5 per cent. Far from moving all items towards a uniform rate, the Budget tinkers with dozens of different rates for different items, increasing the scope for confusion. The Central Sales Tax will be reduced from 4 to 3 per cent.

Apart from achieving the credible performance in managing the fiscal issue, the Budget also deserves credit for keeping the tax framework broadly stable while working towards its long-term objective of getting customs duties down to ASEAN levels. Thus, there is no change in the Cenvat rate or service tax rate. The only minus on the tax front is the fairly extensive tweaking in customs duties on specific commodities like chemicals, plastics, coking coal, edible oils, prime steel, etc,, where sharper cuts have been effected. This should introduce a greater element of competitiveness in the Indian market and moderate inflationary pressures. The increase in the dividend distribution tax from 12.5 to 15 percent; however, is bound to have a negative impact on market sentiment. The raising of the income tax exemption limit by Rs. 10,000 is no more than a token gesture to the individual tax payers while the corporate tax structure has been left unchanged except for removing the surcharge on small and medium enterprises with an income of less than Rs.1 crore. The long-awaited reforms of direct taxes and the putting of a simpler system in place with fewer exemptions and moderate rates have been put off again with a promise to introduce a new income tax code in Parliament later this year.

The improvement in the tax/GDP ratio to a respectable, if not entirely satisfactory, ratio of 11.5 per cent in accordance with the Budget documents is an encouraging sign. But any celebration on that count needs to be tempered with the realisation that we are still a long way from getting anywhere near the tax/GDP ratio in countries like Brazil (20 per cent) and South Africa (28 per cent). We are also a long way from realising our full tax potential.

Another important measure is the reduction in the central sales tax (CST) and the road map for its phase out before the GST is introduced in 2010. There are a number of tax measures in the budget which are retrograde:

(i) the selectivity in choosing sectors for taxation or exemption should give way to rule-based tax policy, but the practice of selectivity and discretion continues; (ii) using tax policy for providing temporary incentive for hotel construction for the Commonwealth Games and other such short-term objectives is not appropriate. Both customs and excise duties have been selectively altered for various reasons.

Inflation hatao, growth badhao, Congress bachao (remove inflation, raise economic growth, and save Congress) are the three goals the Budget has been trying to promote but has failed to achieve any of them to the fullest extent. The cuts in customs and excise duty will help a bit in moderating inflation, but will not bring down the price of onions or wheat. The economy is growing fast, but the corporate sector of India, which had expected abolition of corporate tax surcharge, complains that it has been burdened with an increase in dividend distribution tax, a levy of fringe benefit tax on ESCOPs, an extension of Minimum Alternative Tax to the IT(information technology) sector, and a new secondary education cess of 1 per cent. What has hurt the companies is the increase in the dividend distribution tax. The IT companies, which has enjoyed a tax holiday for a long time, have been finally brought under the MAT (minimum alternate tax). The stock options given to employees with the aim of retaining talent will come under the fringe benefit tax. The stock market did not kindly take these announcements.

The often-repeated promise of rationalising and simplifying taxes has apparently been forgotten. Evidently, we are still a long way from getting to a simple tax structure. A careful analysis shows that while the buoyancy in service tax was due to expansion in coverage, the strong revenue performance in direct taxes is attributable to the institution of the Tax Information Network (TIN). This task was entrusted to the National Security Depository Ltd., and similar initiatives in regard to central excise could increase the revenue productivity of the tax.

The picture on the revenue side shows a loss of steam. After getting a windfall of 27.8 per cent growth in tax revenue in 2006-07, it is budgeted to achieve just 17.2 per cent revenue growth during 2007-08. Caution seems to be the watchword in the revenue-budgeting exercise. But, given the high revenue base of the current year, the caution is justified.

It is also worth noting that corporation tax is now the biggest revenue earner, having just displaced excise as the largest big-ticket revenue source. The mix between direct and indirect taxes has also undergone

some inexorable changes. During the year previous to the reform process in 1990-91, direct taxes comprised some 19.1 per cent of total central taxes. This percentage has steadily increased, with the figure for 2006-07 being 47.6 per cent in accordance with the latest Economic Survey. There are, however, no grounds for complacency. Much more needs to be done on the personal income tax front. Tax evasion and avoidance are still rampant amongst a class of small businesses and self-employed professionals who ought to be within the ambit of personal income taxes but they are not. Therefore, tax administration and enforcement need to be very substantially tightened. In fact, the very corollary of a moderate rate structure, which is supposed to encourage voluntary tax compliance, is the proposition that willful defaulters have got to be swiftly taken to task. But, all this should be done as a matter of normal routine rather than going public on the tax files of a few high profile industrialists or Bollywood stars. The latter course is invariably counterproductive in the long run (Pulin B. Nayak, 2007). Overall, the Budget is somewhat a disappointment with an incremental rather than an imaginative or innovative approach.

IV- Public Expenditure

Those who mostly write about the Budget are economists, and they do not usually go through the fine print but confine themselves to the Budget allocations, investments in agriculture, industry, social sector, and so on. The total increase in budgeted spending is just 10 per cent if we exclude the one-off numbers relating to the purchase of SBI (State Bank of India) shares from the RBI (Reserve Bank of India). That is substantially lower than the 15 per cent increase in spending during 2006-07, suggesting a tight fiscal control despite all the big ticket announcements in the Budget speech. In fact, the Budget is noteworthy for the fact that the budgeted increase in expenditure is lower than the expected GDP growth next year. In relation to the GDP, the government is shrinking.

The swelling national kitty allowed the luxury of spending more on welfare programmes without hiking taxes: 31.6 per cent for all Bharat Nirman schemes, and a near doubling of targets for farm credit, a quantum jump for irrigation, etc. Having done this, the Budget should have given the delivery schedules. The Budget is resoundingly silent on implementation of these crucial programmes. For instance, the farm extension system seems to have collapsed. The Economic Survey (2006-07) observes that the availability of resources alone will not guarantee

development. Unredeemed promises sour quickly, and that can prove fatal for the Government in its second half in office.

A welcome feature of the budget is the substantially higher allocation for the safety net schemes, including the eight flagship programmes such as the Bharat Nirman (a rural infrastructure programme) and the National Rural Employment Guarantee Scheme, apart from a new insurance scheme for landless labour. Leakages and corruption have been endemic in such income transfer programmes but the Right to Information Act should, in course of time, bring in greater transparency and accountability at the implementation level.

To woo the aam aadmi (ordinary people), the Budget has increased its outlay on Bharat Nirman by 31.6 per cent. Yet, the Budget shows big shortfalls in spending in most sectors, including the National Rural Employment Guarantee Scheme. This is being extended to 330 districts, yet its allocation is meagerly up from Rs.11,300 crore to Rs. 12,000 crore, which is actually a decline after adjusting for inflation. The scheme is faltering because some states have failed to lift even half the allotted funds.

Long on intent but short on content when it comes to delivery for the aam aadmi, the Budget seems to deserve the flak it has received. But it also stands out for one remarkable aspect. Perhaps, for the first time, the aam aadmi seems to have come onto the radar screen, even if he has not been vouchsafed any real benefits. The expansion of the safety net for the rural poor addresses a critical need. As India transits from a developing economy to a rapidly emerging one, it becomes imperative to ensure that the phrase 'inclusive growth' also makes the transition from buzzword to reality. There is also a fair degree of consensus on policy imperatives. It is now up to the machinery of governance itself to ensure that the critical task of implementation does not get derailed.

There has been a substantial expenditure compression. Total expenditure as a percentage of GDP went down from 17.3 per cent in 1990-91 to 13.8 per cent in 2006-07. But, most of the compression is due to the drastic reduction of capital expenditure from 4.4 per cent of GDP during pre-reform period to 1.8 per cent in 2006-07. The long-term adverse impact can hardly be overemphasised. The government is clearly trimming down its own commitment to developmental efforts. If the development process is to be truly inclusive and equitable, then this would call for a

much more concrete commitment than merely paying verbal homilies (Pulin B. Nayak, 2007).

We believe the government needs to anchor a stronger supply response (growth in productive capacity) in order to move on to a higher and sustainable growth. The government needs to implement measures to accelerate the supply-side response by investing much larger sums in infrastructure, augmenting resources through privatisation, implementing labour reforms, and strengthening the regulatory and administrative framework.

V- Agriculture

Another major constraint is agriculture whose poor performance in the last three years has been masked by the robust growth in services and in industry. Agriculture has been neglected for a long time. Agricultural growth is low on average and highly volatile. This volatility affects both prices and output. The risk-adjusted rate of return on agriculture is quite low. Growth rates of less than 3 per cent on the average over the last six years have left rural per capita incomes virtually stagnant in contrast to the increasing income in other sectors. It has also led to supply-side bottlenecks, which have led to a spurt in prices of essential commodities like rice, wheat, edible oils and pulses. The budget rightly laid emphasis on agriculture as the vital area and outlays for programmes on increased farm credit, irrigation, watershed management, seeds supply, 'training, extension services, agricultural research, and encouragement to food processing represent a substantial rise from the previous levels. Yet, the allocations pale before what is needed to make up for years of neglect of the farm sector and, according to the noted agricultural scientist Dr. M.S. Swaminathant, 'the budget fails to provide a strategy for agricultural renewal. Agriculture, however, needed a still bolder initiative.

There are surely no quick-fix solutions to problems dogging Indian agriculture, yet a long-term position needs to be taken on a sector that affects the livelihood of nearly 60 per cent of the population. The slew of Budget proposals is unlikely to make a significant change. An intriguing question is whether there has been a real progress in expanding irrigation facilities. According to the Economic Survey 2006-07, between 1998-99 and 2003-04 (the latest year for which data are provided), the irrigated area under major crops (rice, wheat, coarse cereals, pulses, oilseeds) hardly increased; but, in some cases it has

shrunk. The tangible outcome of the huge allocation for irrigation year after year deserves to be investigated.

The plan outlay on agriculture for 2007-08 has been enhanced by 15.7 per cent, and the increase in the outlay on the social sector is almost 36 per cent. To be sure, these are legitimately in the states' domain, and the Centre's intervention is largely guided by political sensitivity. Given that these have to be implemented at state and local levels, strengthening the delivery systems is important, and in its absence, transforming outlay into output and outcome will remain elusive. On the other hand, there is a need to ease infrastructure constraints, but the outlay on plan capital expenditure has been increased just by 9 per cent. Many link the high inflation and the limited progress on poverty alleviation to the slowing public investment in agriculture. Whether the Budget initiatives to bridge the gap between the two parts of India will bear fruit can only be judged by outcomes, not outlays. Enhancing allocations is the easier part. Improving efficiency of the delivery system is far more daunting, well beyond the ambit of the budget.

Farm credit expansion is welcome, but what about building repayment capacities among farmers? One is not sure whether the Agriculture Ministry has a clear vision about what should be done to boost farm production and productivity. It is time not to make perfunctory policy proposals, but to move forward purposefully by first generating a national consensus on how best to realise farm growth potential. Otherwise, the country runs the risk of paying a heavy price in terms of social and political unrest.

The rate of growth of capital stock in agriculture is about one per cent. The employment elasticity in agriculture is zero. Therefore, the main source of growth can only be an increase in productivity. The productivity of soil has been damaged over a long period by disproportionate subsidisation of urea. Even a large number of small budgetary measures will not solve this deep-rooted malaise. Reforms should be based on a proper diagnosis of the problem. Agriculture does not merely represent a constraint on growth. Sustaining the livelihoods of half the population, it is also the most important area where progress is necessary to make growth more inclusive. On the farm front, by far the most intractable among the problems confronting the Government is that there has been no evidence of any fresh thinking.

VI- Economic Infrastructure

The two critical areas for sustaining the high growth rates of recent years are infrastructure and agriculture. With just marginal improvements in infrastructure, the growth rate has surged impressively, but this situation is clearly not sustainable even over the medium term. While the railways have turned in a heartening performance, power, roads, ports, and airports remain major constraints, particularly with the projected growth of the manufacturing sector. The Budget has provided for a little in these areas beyond four-ultra mega power projects. An interesting feature of the Budget is the acceptance of the idea of investment of a part of the foreign exchange reserves of the country on infrastructure. The acceptance of this idea is based on the recommendations of the latest Deepak Parekh Committee. An ingenious device is proposed to enable the utilisation of a part of the forex reserves for infrastructure funding. Returns to the RBI will be guaranteed by the Government, ensuring that the central bank gets a better income from the deployment of reserves than it has so far. Another interesting idea in the Budget is the issue of tax-free bonds for investing in infrastructure by state entities. A bolder initiative such as the use of a part of the foreign exchange reserves for infrastructure funding without causing any monetary expansion, as the Deepak Parekh committee suggests, could have been announced, but that innovative approach is still being examined.

Given the focus of the budget on easing the infrastructure bottlenecks so as to keep up the growth momentum in the economy, it was expected that capital expenditures on infrastructure sectors would be increased significantly. The analysis of expenditure, however, does not provide any indication to the effect that infrastructure constraints are likely to ease in the near future. In other words, much of the plan outlay has to come from internal and extra-budgetary resources of public enterprises under the constraint that the oil sector enterprises, which traditionally generate much of the surpluses, are not likely to perform well this year. As a result, it is doubtful whether there will be a significant improvement in public sector spending on essential infrastructure to ease the bottlenecks. Unless public- private partnership initiatives will have to play a significant role in augmenting infrastructure, a solution is not still in sight as far as the power sector is concerned (M. Govinda Rao, 2007).

VII- Social Infrastructure: education and health

With the literacy levels of India being comparable to that of sub-Saharan

Africa, is the government serious about tapping the country's demographic dividend? As a proportion of GDP, combined Centre and States' spending on health and education is about 6 per cent, which, together with inefficient utilisation of these resources, explains why India never moves up the UNDP human development indices. Amartya Sen repeatedly emphasises the importance of converging growth and welfare goals, but that has not rubbed off on policymakers, despite the shocking revelations of malnutrition in National Family Health Survey-III and the finding of the 61st round of National Sample Survey Organisation that poverty fell by just eight percentage points, or from 37 to 29 per cent, between 1993 and 2005. While India is in a high growth mode, the government must make the most of the additional revenues that come its way by creating lasting physical and social infrastructure. In frittering away this opportunity, the government cannot claim to be committed to inclusive growth.

The Budget needs to be commended for stepping up the funding for education by 34.2 per cent and for health and family welfare by 21.6 per cent. The plan to address the problem of dropouts after the eighth standard by offering 100,000 merit-cum means scholarships of Rs. 6,000 a year should enable students who come under pressure to join the labour force, to support their families, and to continue in school. Upgrading the industrial training institutes is a worthwhile project but the budget disappoints insofar as higher education is concerned. The need to expand higher education and to improve the infrastructure and the quality of teaching is apparent, and brooks no delay.

While poverty is declining in India, the pace of decline has not been any faster in the post-reforms period than in the pre-reforms one. The attentiveness to the electorate is natural and, it turns out, good for the economy. The major reforms that India needs now lie largely beyond the fiscal sector. The agenda of reforms now has to shift to labour, law, commerce, health and education; and the attention has to turn to actual implementation and action – the cutting down of corruption and bureaucracy.

VIII- Fiscal Stability

One virtue of the Budget is the success in fiscal consolidation achieved through revenue buoyancy resulting from the high growth rates. However, if the states' finances are taken into consideration, the combined fiscal deficit remains at 6 per cent of the GDP, which is quite

high by international standards. A smaller fiscal deficit means a lower pre-emption of savings as government has to borrow less, sparing resources for the corporate sector. Markets should have cheered and given the budget a thumbs-up. While containing the revenue and the fiscal deficits below the targets should help in moderating inflationary pressures, the Budget offered a chance to embark on a bolder path, but that opportunity has not been seized. For the first time in decades, a primary budget surplus of Rs. 8,047 crore is expected in 2007-08. While it is heartening to see that the revenue deficit is expected to be brought down to 1.5 per cent of GDP, the prospect of phasing it out in 2008-09, the terminal year of the FRBMA, looks remote. In other words, the rate of reduction in the revenue deficit so far does not infuse confidence in reducing the revenue deficit by 1.5 percentage points in one year. Fiscal adjustments achieved since 2003-04 have involved an increase in revenue by 1.3 percentage points and a reduction of direct expenditure by the Centre by 2.3 percentage points, of which almost one percentage point was due to lower interest payments. Not surprisingly, higher transfers and the Centre directly taking up several schemes (such as rural roads, Sarva Shiksha Abhiyan, NREGS SGRY, and Indra Awas Yojana) have helped the states in improving their finances significantly.

The long-term growth prospects of the Indian economy are on a sound footing. The main driver of this growth is the sustained increase in the saving rate of the economy. In the last five years, all the three sectors – household, private corporate, and government – have contributed to the upsurge in savings. The link between revenue deficit and governments saving is important. It is the reduction in the revenue deficit that has reduced government dis-saving from the late 1990s to the present by about five percentage points. However, saving alone is not enough, and it should be converted into investment on reasonable interest rates. If interest rates keep rising following the pressure on the inflation rate, then an adverse impact on the investment rate would become unavoidable. We must take all necessary care to ensure that high interest rates do not damage our growth prospects in the immediate future.

The Budget is rightly proud of meeting its goals under the Fiscal Responsibility and Budget Management Act, 2003 (FRBMA). As usual, capital expenditure is absent from the party. Another important measure of fiscal strength is the difference between non-interest expenditure and revenue, the so-called primary deficit. At 0.1 per cent of GDP, the difference is slightly better than the Budget estimates, but still way below the 4-6 per cent of GDP, which is routinely being achieved in countries

like Brazil and Turkey. It means that we are still borrowing to pay interest. In India, the convergence to the FRBMA targets has been primarily on the revenue side rather than on the expenditure side.

A period of fifteen years of fiscal reforms means that much of what could be achieved through the Budget is behind us. While the fiscal deficit reduction programme is on course, there are concerns both about the magnitude and quality of fiscal adjustment. First, there are hidden deficits and those deficits are pushed to the public enterprise account. Equally important is the fact that the adjustment has failed to bring about a reduction in revenue deficit to the desired extent. Fiscal adjustment achieved since 2003-04 has involved an increase in revenues by 1.3 percentage points and a reduction in direct expenditure by 2.3 percentage points, almost 1 percentage point of which was due to lower interest payments. Not surprisingly, higher transfers and the Centre's directly taking up several schemes such as rural roads, Sarva Shiksha Abhiyan, National Rural Employment Guarantee Scheme, Sampoorna Grameen Rozgar Yojana and Indira Awas Yojana have helped the states in improving their finances significantly. This has significant implications for fiscal federalism, service delivery, and accountability (M. Govinda Rao, 2007).

IX- Conclusion

A positive feature of the Budget is its continuing commitment to integration with the global economy. While widely anticipated, the reduction in the peak rate of non-agricultural tariffs to 10 per cent is a step in the right direction, and will give increased room for a manoeuvre in both our bilateral and multilateral trade negotiations. One can only shake one's head sadly about a policy framework which first has the Central Bank buy reserves, has the government pay the cost of sterilization, and has the government offer a guarantee to the private sector to borrow the same funds. The increase in the education cess smacked of a lazy tax policy. Overall, this was a budget devoid of new ideas and initiatives. Just holding the line seems to have been taxing enough.

The speech was filled with references to a large number of allocations ranging from a few crores of rupees to a few thousand crores, all apparently being given equal importance at least in terms of word count. The budget reflects a compulsion towards everybody, however, small and insignificant. Overall, although the aggregate allocations to both

education and health have grown significantly, helped by an enhancement of the education cess, the allocations appear to have been spread widely over a large number of schemes, increasing the demands on the system by way of monitoring, co-ordination and, delivery. Social activists have sent a harsh critique of this year's Budget to Prime Minister, complaining about insufficient allocations for the nutritional needs of children below the age of six. Sectors, regions, and communities that have generally been neglected will continue to get special dispensations. It is a pure political economy, in line with Harold Laswell's definition of politics as "who gets what, when, and why".

The main message of the present Budget may be taken as the following: the country now is on a high growth path, and this must naturally lead to concerns about inclusive growth, which combines the objective of distributive justice with a reminder of how growth is important in achieving such an equity. With 115 millions of farming families, accounting for almost half the country's total population, it is vital that their income should grow at a reasonable rate, and their welfare is safeguarded well enough to put a stop to their distress and indebtedness. How all the programmes enumerated under agriculture will add up to provide the 4 per cent growth annually over the next five years, has not really been made clear.

Anyway, the budget has kept the framework largely intact, and the overall impact is not likely to rob anyone of his peace of mind. But, to sustain growth, it is not enough if the country has a high investment rate. It has to be rising year after year. From the raw figures available in the Budget, it is difficult to know if the investment expenditure will contribute to net capital formation. Moreover, an equally important part is being played by the private sector. Will the proposals accelerate private sector investment?

The rating agency Moody has described Budget 2007-08 as "largely unremarkable", as it disappointed businesses, and the market's hope for meaningful economic reforms. In a research report, Moody criticises the Budget for supporting an imbalance in the policy-mix, and says the current inflation is a result of an above-potential growth of the economy and an ill-defined fiscal policy. "Addressing inflation with one-off reductions in various indirect taxes and excise duties is not an effective antidote to the underlying inflationary pressures created by an above-potential growth and loose fiscal policy. Moody has also criticised a higher focus on monetary policy to correct the inflationary pressure.

"The Budget confirms an increasing imbalance in the policy-mix, with too great a dependence on monetary policy, including higher interest rates. This could further distort the external accounts, steadily widening the already-large trade deficit by strengthening the exchange rate and attracting more speculative portfolio capital". Merely achieving the set fiscal deficit was not enough as it could aggravate structural inflationary pressures. Simply meeting the targets mentioned in the Fiscal Responsibility and Budget Management Act is not enough, especially when economic growth has outpaced the expectations on which that legislation was based (Business Standard, March 15, 2007).

The problem is that merely throwing money around will build nothing, and just perpetuate a culture of rent-seeking. Fundamental institutional reforms must complement and even precede the increased spending on basic public services. The benefits of growth require institutional reforms to improve public service delivery. This will make other growth-enhancing policies feasible and a high growth sustainable.

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Appendix

BUDGET AT A GLANCE

(Rs. crore)

	2005-2006 Actual	2006-2007 Budget Estimates	2006-2007 Revised Estimates	2007-08 Budget Estimates
1. Revenue Receipts	347462	403465	423331	486422
2. Tax Revenue (net to centre)	270264	76260	345971	403872
3. Non-tax Revenue	77198	76260	77360	82550
4. Capital Receipts (5+6+7)$	158661	160526	158306	194099
5. Recoveries of Loans	10645	8000	5450	1500
6. Other Receipts	1581	3840	528	41651*
7. Borrowings and other liabilities$	146435	148686	152328	150948
8. Total Receipts (1+4)$	506123	563991	581637	680521
9. Non-Plan Expenditure	365485	391263	408907	475421
10. On Revenue Account of which:	327903	344430	362183	383546
11. Interest Payments	132630	139823	146192	158995
12. On Capital Account	37582	46833	46724	91875*
13. Plan Expenditure	140638	172728	172730	205100
14. On Revenue Account	111858	143728	144584	174354
15. On Capital Account	28780	28966	28146	30746
16. Total Expenditure (9+13)	506123	563991	581637	680521
17. Revenue Exp. (10+14)	439761	488192	506767	557900
18. Capital Exp. (12+15)	66362	75799	74870	122621*
19. Revenue Deficit (17-1)	92299 (2.6)	84727 (2.1)	83436 (2.0)	71478 (1.5)
20. Fiscal Deficit {16-(1+5+6)}	146435 (4.1)	148686 (3.8)	152328 (3.7)	150948 (3.3)
21. Primary Deficit (20-11)	13805 (0.4)	8863 (0.2)	6136 (0.1)	(-) 8047 - (0.2)

* It includes an amount of Rs. 40,000 crore on account of transactions relating to transfer of RBI's stake in SBI to the Government.

$ It does not include receipts in respect of Market Stabilisation Scheme, which will remain in the cash balance of the Central Government and will not be used for expenditure.