Union Budget 2008-09
Panel Discussion at St. Xavier's College, Kolkata
Address by Mr. Rakesh Shah
March 6, 2008

Rev. Fr. Felix Raj, Fr. Dominic, Distinguished speakers & my fellow Xaverians,

At the outset let me thank Fr. Felix Raj for giving me an opportunity to share my views on the Union Budget 2008-09.

Friends, analyzing the Union Budget has a moral hazard problem and this year, the core of the budget has plenty of rings of moral hazards!!

I feel analyzing the Budget is very often like the five blind men trying to describe an elephant. Each reaches out to a different part of the body and gives an opinion that is likely to be quite different from his other counterparts.

Again you will find the so called experts keeps on changing their views throughout the year as they discover more & more implications in the finer prints.

Friends, clearly, the Rs.60,000 crore waiver remains the central theme of this year's budget. Whether you like it or not, politically this is a master stroke, so much so, that practically all parties, from the Right to the Left, have found it difficult to come out with a cogent criticism of this move by the Finance Minister.

The Budget needs to be analyzed in conjunction with the Economic Survey presented by the Finance Minister to Parliament just a day before. How has the Indian economy performed in the current fiscal year? According to the Economic Survey, the GDP is projected to grow at 8.7% this year, which represents a deceleration from 9.4% in 2005-06 and 9.6% in 2006-07. Gross Domestic Savings as a proportion of GDP rose from 26.4% in 2002-03 to 34.8% in 2006-07. Gross Domestic Investment as a proportion of GDP, in turn, rose from 25.2% in 2002-03 to 35.9% in 2006-07.

Thus, the savings-investment gap which remained positive during 2001-04 became negative thereafter, indicating a welcome surge in demand during 2005-06 and 2006-07.

When one looks at the investment side of the picture, according to the Economic Survey, investment has been driven by private investment, which went up by 10.3% of GDP over the five years of the Tenth Five year plan. This improvement was in turn driven by private corporate investment, which increased by 9.1% of GDP over these five years from 5.4% of GDP in 2001-02 to 14.5% in 2006-07. This is extremely encouraging.

Thus, it is clear that the tax buoyancy witnessed during the current fiscal year can be largely attributed to the enhanced private corporate sector investment during the Tenth Plan. Tax Revenues (net to Centre) has increased by Rs 27,901 crores over the 2007-08 Budget Estimate. Furthermore, the budgetary proposals that the Finance Minister has presented for 2008-09 is heavily dependent on the continuation of this growth impetus and the investment boom that the economy has seen, especially post 2004-05.

However, during 2007-08, there have been enough signals of slowing down of the Indian economy. The Economic Survey points out that the Manufacturing sector growth will fall to 9.4% in 2007-08 from 12% in 2006-07 and more importantly, the Construction sector will show the slowest growth at 9.6% this year since 2003-04. Thus, the assumed revenue buoyancy on account of a rate of growth of 13% in nominal terms will be a tight rope walk for the Finance Minister. This is because the budget contains a couple a measures (like loan waivers and lowering personal income tax rates) that could potentially raise demand and if the supply side does not respond adequately and in time, inflation could eat up a substantial chunk of the nominal growth rate.

I may add that this year's Economic Survey has introduced a new chapter titled "Challenges, Policy Response and Medium Term Prospects". Here the Survey gives a fairly good analysis of the challenges facing the Indian economy in the medium term. Sustaining the growth momentum has been identified an area of challenge along with the issues like capital inflows, inflation management, external sector shocks arising out of the "sub-prime crises" and supply side challenges like infrastructure bottlenecks.

Indeed, in each of these aspects, the Budgetary proposals seems to have done very little to push the growth momentum. Let me elaborate by looking at certain sectoral aspects of the budget:

Agriculture
While loan waivers have drawn considerable attention, one does not see any medium to long term solution in the budget to boost agricultural productivity and investments in this sector. Our Prime Minister has rightly emphasized the need for "out of the box" thinking to find solutions to the complex problems that face India. Agriculture is one sector which needs such thinking than any other area of our economy. Could we have looked at the possibility of getting our corporates to invest in agriculture so that it can become a commercially viable proposition and our farmers have a long term solution to the problem of debts?

Industry
The main initiative in this segment has been the lowering of the Cenvat rate from 16% to 14%. For the MSME sector, the engine of growth, the Finance Minister has increased the Risk Capital Fund with SIDBI. These are indeed welcome initiatives, but much more could have been done.

However, the present direct and indirect tax structure facing the industrial sector contains a lot of procedural infirmities and needless fiscal irritants that could have been done away with. In fact, doing away with surcharges and FBT on a range of genuine business expenditure heads would have actually contributed in the expected tax buoyancy that the Finance Minister has assumed while making his proposals this year.

Another fact that needs to be noted is that while the Finance Minister's Speech refers to the "oligopolistic situation" in the Steel and Cement industry, the budget is devoid of any measures to bring about competition in these industries. In fact, while there has been some attempt to stop cartelization in the cement industry, not much effort has been directed to do so in the Steel industry. In fact, some newspaper reports indicate that taking any measure against the exports of iron ore from India was decided against to avoid a row with China! How far this is true, one does not know, but it seems that we are slowly losing control over our ability to tailor policies to suit our own industries! Also, I must draw your attention to the fact that the amendments to the Competition Act in December 2007 which gives the power to the Competition Commission of India to investigate charges of unfair trade practices are yet to be notified by the Government. Thus, oligopoly is what we are likely to see in crucial industry segments in the country.

The Capital Market

The Indian Stock Market has not responded favourably to Budget proposals. The hike in short term capital gains tax along with the fears of an US recession has contributed considerably to the stock market behaviour. But what is of more concern is that the short term inflow of capital has hit Indian industry and our exporters where it hurts most during the current fiscal year.

Studies by leading industry bodies and export promotion councils have shown that the Rupee appreciation on account of capital inflows have not only resulted in lowering domestic production, it has increased unemployment, lowered our global competitiveness and, in a range of products, benefited the Chinese, who have displaced our products in global markets. In the Budget, while the funds allocated to Market Stabilization Scheme (MSS) for 2008-09 has been budgeted at Rs 255,806 crore, which is significantly higher than Rs 141,135 crore in the budget estimate of 2007-08 but lower than the actual issuance of Rs 271,903 crore this year, there has, however, been no attempt to recover a part of the stabilization cost either through a value added tax on inflows or though a Tobin Tax.

Infrastructure

Apart from the issues like demand and supply, it is fairly clear that our infrastructure situation at present can in no way handle 9% plus rate of growth. Be it ports, railways, roads or air cargo terminals, the transaction costs in India are one of the highest in the world. While the Government is aware of the need for infrastructure upgradation, it is rather surprising to find that capital expenditure for 2008-09 has been budgeted at Rs 92,765 crore which is 23% lower than revised estimate of Rs 120787 crore for 2007-08.

Exports

A key segment that has been completely bypassed has been exporting community.

The Economic Survey notes and I quote
“though our exports to the US have already been slowing in 2006 and 2007, a further slowdown may be unavoidable, but may be relatively modest. The deceleration in world imports will also lead to a deceleration in growth of demand for commodities, including oil, and their international prices. While the extent of the impact is uncertain, it will have a salutary effect on the unit value of imports and consequently on the value of imports. The balance of these two factors will result in a modest increase in the goods and services trade deficit, as long as a severe recession is avoided in the US”. ***Unquote.***

Further, the recent data has shown that the gap between exports and imports have widened for the month of January 2008.

I, therefore, wish the Budget had taken some affirmative steps to promote exports so that we are not completely at the mercy on the fortunes of the US economy! I may add that some of these steps are more procedural in nature, but could have contributed a lot in lowering transaction costs and in helping the exporters. A good example is the exemption of 13 services from service tax on post production exports of goods. Presently, we have a refund system. The government had promised an exemption system and this could have been easily acceded to by the Finance Minister without having any effect on revenues.

Hence I firmly believe the Budget has nothing for the Export sector except Sympathy.

Let me conclude by saying that, perhaps, the Finance Minister believes that the Budget should be used to send political messages only while reform measures and serious policy issues can be tackled all around the year. I do believe that if this is what the logic is of the Government and the Finance Minister, it is a welcome move. There is no need to have the kind of hype that surrounds Indian budgets any more. This is because it is important for the Government to lay down the broad framework and thereafter take necessary action all round the year as and when issues are brought before the Government.

Thus, the impression one had after listening to the Finance Minister’s speech is that the Union Budget presentations from now on are likely to stress more on “political messages” rather than venturing into substantive economic reform programmes and a plan of action that are required for sustaining an economic growth of 9% percent plus.

Thank you.

❍❍❍❍❍❍❍