

Note on Seminar on “Union Budget 2009-10: Reform and Development Perspectives”

The seminar on “Union Budget 2009-10: Reform and Development Perspectives” was held on July 11, 2009 at the Imperial Hotel in New Delhi. Five leading Indian economic policy research institutes came together to present their assessment of the reform and development implications of the Union Budget. The heads of the five institutes, CPR, ICRIER, IDF, NCAER, and NIPFP joined in a panel discussion to provide a more reflective view of the Budget. The panel included Shubhashis Gangopadhyay, Rajiv Kumar, Suman Bery, M. Govinda Rao and Pratap Bhanu Mehta. The discussion was moderated by Sunil Jain of the Business Standard.

The beginning of the seminar saw the panelists analyzing the budget with respect to various heads such as defence, education, service delivery mechanisms and institutions, tax rates and government debt. It was felt that an increase in defence budget is not always a waste because of the Defence Procurement Policy, 2006, that had mandated that for import orders in excess of Rs 300 crore, the supplier must outsource around 30 percent with Indian companies or make investments in India. Education sector seemed lacking in the sense that instead of “building universities”, we focus on the task of university building. However, it was felt that this is the first time that non-elite educational institutions have been allotted money in this budget, which was an encouraging sign.

The panelists argued that interest rates in the economy were still high and needed to be reduced further to boost investment. Referring to the “relatively” large fiscal spending announced in the budget, some panelists were of the opinion that there could be a possibility of the government spending crowding out private spending. However, since interest rates are high (even though inflation is low) this does not seem very likely. Data reveals that savings declined in 2007-08 but picked up subsequently. Credit is becoming expensive and hence private investment is weak. As a result, non-food credit rate has declined due to this unwillingness to lend. Even though investment and private consumption have slowed down, India is a domestic demand driven economy. Given the large borrowing program of the government, it could cause further pressure on the rate of interest. But increasing government spending was the government’s best bet since, given the reluctance of private investors, the economy would be largely dependent on its public expenditure program. All panelists agreed that though the government had gambled with the fiscal spending, it was not a reckless gamble. However, all speakers also agreed that whether the fiscal deficit at 6.8 percent of GDP is low or high is debatable.

The need for the government to push for reforms at the cost of high fiscal deficit was asserted. The panel was of the opinion that the time is ripe to push in for reforms at

the ground level rather than just adopt top level policy changes. It is beneficial to locate fundamental barriers to entrepreneurship in the economy, instead of using macro-level variables to target *all* problems areas where reform is required. One sector that exemplifies this is the Small and Medium Enterprises (SME) sector. Banks do not lend to SMEs directly, but do so through Non Banking Financial Companies (NBFCs). SME loans are mostly asset-backed and since these SMEs supply to most of the domestic demand, the real risk associated with SMEs is far less than what the high interest rates signal. In fact, this sector contributes 49 percent to exports as well. However, the guidelines for risk rating suggested in the regulatory guidelines force a high risk rating to be given to SMEs. If these guidelines can be re-looked at, reform is possible almost overnight. Thus such low hanging fruit should be targeted, without the need to inspect macro variables at every step.

There was a lot of discussion regarding NREGA as a social sector scheme. There was some skepticism regarding the intent and impact of the program. Under ideal circumstances of development, India would not have to rely on such schemes. Once the poverty gap is reduced by this program, it should ideally sunset. However, political opportunism may cause this program to continue for longer than it actually should. Additionally, the problem of “free-riding” on tax payer money i.e. earning money without actually working for it, could arise and, the government by raising the limit of the number of people eligible for employment through NREGA from one to two or more, has compounded this problem. Instead of debating whether NREGA as a program is “good” or “bad”, it is important to monitor its implementation in terms of leakages, administrative loops etc. If the implementation is done properly, there will be greater accountability and the benefits will be far reaching, both of which will allay fears of political opportunism. As for the impact of NREGA, studies have shown that it does not have a very large multiplier effect, but the spillover effects in some sectors have been huge; e.g. child labor and labour migration. There should be more of such impact evaluation studies that will also ensure a continual accountability of the implementation of the program.

The issue of the scope of the budget was raised frequently and whether it should be a long term activity instead of an annual one. A budget cannot be a one-stop solution to all problems. With a growing atmosphere of federalism in policy making, the state governments have to take responsibility for their policies and the centre cannot always take the onus. Additionally, the concerned ministries in the union should be questioned on the utilization of the funds allocated to them and accountability for payer money. Since the constitution requires a budget to be announced every year, it can be dangerous to make the budget a focus for policy making. Real policy should be kept out of the budgetary exercise and the budget should be limited to being a checklist of government spending with respect to new programs and progress of the older ones. However the panel had differing views on this, as some of the panelists were of the opinion that it was but inevitable to draw policy inferences from the

budget and that the two can thus never be separated from each other. Another point debated hotly was whether delivery mechanisms should be outlined clearly in the budget, or if this was outside the purview of the budget. There was unanimity on the need for an improved service delivery mechanism in the country and it was acknowledged that there have been innovations in this regard that cannot be ignored.

To summarize the discussion, it is important to abolish tax anarchy from the budget, which causes more uncertainty over deficits and revenue. We need to develop consistency in our tax provision in order to ensure proper allocation of resources and have reliable estimates of available resources to allocate them efficiently. It is important to ask ourselves whether we have unjustifiably high expectations from the budget. As a growing and mature economy, we should ask these responsible questions to policy makers.