

# Union Budget for 1993-94

## Some Macro-Economic Considerations

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*The claim that the budget is 'growth oriented' is puzzling. First, the fiscal stance is deflationary. Secondly, capital spending by government is down. For each of these reasons it is not at all clear that a recovery will be triggered or that private investment will take off. As far as the role of budgets go, perhaps, this one may be accurately described as non-inflationary. But then inflation does have other crucial determinants. Since the budget's book-keeping has been much lauded it bears mentioning that the revenue deficit is still with us, and growing. Apparently, the government's macro-economic adjustment programme is yet to catch up with its own consumption. Finally, for exports we have been provided with an enthusiasm rather than a strategy.*

### I

APART from some significant changes in policy instituted in the budget, the finance minister this time seems to have caught the imagination of many by some very deft book-keeping. There is widespread wonder at 'give-aways' not having had to be combined with 'take-aways'. Obviously these gentlemen have not heard of the newly introduced 364-day bills! Coming to specifics, for instance the media has focused on 'the lowest budgetary deficit (total expenditure minus total revenue) in a decade'. This is indeed correct. In fact, the deficit projected for 1993-94 is close to half that estimated (revised) for 1992-93. However, note (Table 1) that the decline is matched almost exactly by the increase in 'borrowings and other liabilities'. Thus the finance minister may be seen to have borrowed to reduce the budgetary deficit. This is no achievement. While still on the question of balances, the fiscal deficit is actually marginally higher. Thus the lower projected ratio of this deficit with respect to national income is to come about solely due to the anticipated increase in the latter. The revenue deficit, on the other hand, is projected to increase substantially, which is a marked turnabout from the provision last year when it was at least slated to fall, even though the budget estimates were exceeded by close to 25 per cent. Thus if deficit reduction is considered a desirable objective, at least with respect to the revenue account, this budget makes little progress. The implication of a revenue deficit is that we are borrowing (or printing money) to finance government consumption. In response to this it has been pointed out by the government that one cannot be too critical of revenue deficits in the Indian case for some crucial government expenditures such as on education occur on revenue account. This is entirely to be discounted when it is made clear that expenditure on 'education and public health' amounts to 2.9 per cent of total expen-

diture on revenue account. This after the much touted increase in expenditure on education in the budget. On the whole, an attempt to rein-in expenditure has been made alright. However, while the growth in total expenditure has been curtailed, notice that the decline has been brought about by a reduction in the 'level' of expenditure on capital account (Table 1). This is of grave import, and with likely consequences of to which I shall turn subsequently. Fiscal stabilisation via reduction of capital spending reflects the political economy of macro-economic adjustment being attempted in India today. Simply put, it is obvious that this government has been unable to take the really hard decisions. But so much for the arithmetic, and on to the economic questions.

**Growth:** The claim that this budget is 'growth oriented' is puzzling, for there is little among its provisions to warrant the view. First, the projected fiscal deficit as a share of the national income is lower. This can hardly be considered expansionary. In fact, it signals the continuation of the policy of deflation. The reduction in excise duty may perhaps be expected to contribute at least a little to a higher level of industrial production, but, surely, this cannot be considered the basis for a recovery. That will come, most probably, from the considerably higher (Table 2) agricultural production in 1992-93. For we know that among 'macro-economic' variables, industrial production is influenced most by agricultural growth, and most likely with a year's lag. The question of growth in the economy leads naturally to that of investment. In the final analysis, growth is dependent upon investment. The budget contains no direct incentives for investment. In fact, I believe that some of its provisions might have effects that are actually negative. For, unless the Indian economy is characterised by 'crowding out' the decline in real capital spending by the government referred to earlier may be expected to act as a

dampener on private investment. All in all, the temporary introduction of an 'investment allowance' would have been appropriate. Incidentally, it may be expected to have been more effective in stimulating growth than the lowering of excise duty. Now, it may very well be claimed that private investment is actually governed by entrepreneurs' expectations and that Industry is now upbeat about the prospects of the Indian economy. If so, we would have to wait and see. My own belief is that this is precisely what the entrepreneurs would, do i.e., wait to see the progress of structural reforms, the stabilisation programme, and the response of the economy. Once again, in terms of its direct provisions, the budget does little for investment. The reduction of the interest rate by one percentage point can hardly be taken seriously here. Finally, it bears to point to the folly of focusing on the stock market as an indicator of what is likely to happen to capital formation. We have actually begun to observe rights issues to finance working-capital requirements.

**Inflation:** That this budget is non-inflationary is perhaps a reasonably accurate claim. Contrary to what has been suggested, the move to a floating exchange rate regime *per se* need not lead to a depreciation of the rupee. In fact, *ceteris paribus*, we would expect to observe a one-shot appreciation. And the rupee did strengthen soon after the budget, even though this may have been at least partly due to potential 'repatriates' having held on to their dollars in anticipation of at least partial progress towards a unified exchange rate. A full float implies that there will be more dollars on the market. But just as dollar recipients have complete access to the market, the government must now finance its imports at the market rate. Therefore, bulk imports will cost more. This is essentially what the unified exchange rate implies, i.e., the government must find more funds for the same quantity of imports. The surplus on the OCC

account is a temporary cushion and one cannot predict for how long. Whether the government would have to raise the price of oil would depend on movements of the exchange rate and whether world prices will harden. But the writing is on the wall. In the future, unless it is decided to subsidise its consumption (mostly by government) we pay the international price of oil. For an economy that is a net importer this is entirely appropriate.

Independently of the move to a unified exchange rate, the reduction in tariffs could actually be inflationary. This could happen if the reduction in tariffs leads to a worsening of the trade deficit and a consequent depreciation of the rupee. Since tariff reduction has been complemented by a cut in excise duty the extent of the increase in imports will depend upon the degree of substitutability between imports and domestic goods on the margin. To the extent that these are non-competing groups, an increase in imports and thus a depreciation in the exchange rate may be expected. The very fact that the budget estimates credit higher 'customs revenues' suggests that, ignoring higher import prices, import quantities are expected to be higher. Since excise revenues too are budgeted to be higher, despite the reduction in the rates, it suggests too that the tariff and excise reductions pertain to two different sets of goods. But returning to the claim that the stance of this budget is non-inflationary, it must be tempered by the recognition that nearly all the relevant administered prices (notably those of oil and coal) have been raised in the early part of the year. The budget for 1993-94 has simply reaped the benefit. It needs to be mentioned, however, that for a wide variety of goods the reduction in excise duty is being passed on as lower prices.

**Exports:** A justification often encountered for the move to a unified exchange rate is that it removes an implicit tax on exporters. This is expected to act as an incentive for them to export more. It would however be far from wise to predicate a growth in exports on this, a sort-of supply-side measure. Unless exporters are assumed to always be on their supply curves, i.e. that they can sell as much as they wish to at the going price. The point is that the move to a unified exchange rate has no implications for the 'demand price'. Thus an expansion of exports under the circumstances would require that the market for Indian exports is characterised by excess demand. This can hardly be a sensible assumption. Generally, on the question of exports it cannot be exaggerated that, while getting prices (including that of foreign exchange) right is important this can only be part of the story. Export promotion seems to require interventions on more than one

front simultaneously. From the experience of successful economies we know that a targeted approach defining areas with an export potential and providing these with preferential treatment might be necessary. In this connection it might be worth introducing duty-free import of capital and intermediate goods for one hundred per cent export-oriented production units. Lower tariffs on capital and intermediate goods used by the garment industry of India's competitors (mostly South Asian and Chinese) is often cited as one reason why Indian products are being edged out of the international market. Irrespective of the merits of this argument it provides an instance of how specific interventions might be necessary to bring about an increase in exports. Such interventions might be against the grain of the present policy-shift towards uniformity of approach, but if in rightly attempting to jettison a system of strangulating controls we end up ignoring the potential benefit of some interventions, then we are throwing the baby out with the bathwater. While no single instrument appears sufficient when it comes to attaining growth in exports, it is clear that a hands-off policy such as aiming at a stable macro-economic environment is inadequate to the task. The budget is complacent on the question of the growth of exports.

## II

Since 1991 the union budget has increasingly become a vehicle for introducing policy shifts. This budget may be seen as representing a stage in this government's programme. And by all ap-

pearances fiscal correction is beginning to be soft-pedalled (signalled by a very marginal reduction in the ratio of the fiscal deficit to the national income from 5.2 per cent to 4.7 per cent) and structural reforms are being brought on to centre stage. In this budget the principal elements of structural reform pertain, in my view, to the external sector. While these might have some immediate consequences for the current account their intended beneficial effects (notably the efficiency-inducing effects of tariff reduction) are in

TABLE 2

Indicator	1990-91	1991-92	1992-93
Output growth (per cent)			
Foodgrains	3.2	5.3	5.7
Industry	10.6	-0.6	3.8
Inflation (per cent)	10.3	13.7	9.4
Fiscal deficit (per cent of GDP)	8.4	6.0	5.2
Current account deficit (US \$ million)	7227	2835	3996

Notes: (1) 'Output' is measured by growth. Growth of foodgrains is annual and the figure for 1992-93 is provisional. Growth of industry is for April-October in each year. (2) 'Inflation' is the annual rate of change in the average wholesale price. For 1992-93 it is calculated as the rate of change of the average monthly index of wholesale prices for April to December over the average for the previous year. (3) 'Current (account) deficit' is in millions of US dollars. (4) 'Fiscal deficit' is in relation to GDP.

Source: *Economic Survey 1992-93*.

TABLE 1

Item	1990-91	1991-92	1992-93	1993-94
(1) Total expenditure	1,05,298	1,11,430	1,24,726	1,31,323
(a) Revenue a/c	73,516	82,308	94,980	1,01,839
(b) Capital a/c	31,782	29,122	29,746	29,485
(2) Revenue receipts	54,954	66,047	78,279	84,209
(3) Capital receipts	38,997	38,528	39,245	42,800
(4) Loans recovered	5,712	6,020	6,225	6,655
(5) Disinvestment	—	3,038	3,500	3,500
(6) B and L	33,285	29,470	29,520	32,645
(7) Fiscal deficit	44,632	36,325	36,722	36,959
(8) Budget deficit	11,347	6,855	7,202	4,314
(9) Revenue deficit	18,528	16,261	16,700	17,630

Notes: (1) 'B and L' is borrowings and other liabilities. (2) Fiscal deficit is (1-2-4-5). (3) Budgetary deficit is (1-2-3). (4) Revenue deficit is (1a-2).

Source: *Budget at a Glance*.

TABLE 3

	8,001	7,510	3,670	3,700
Internal borrowing	8,001	7,510	3,670	3,700
External borrowing	3,181	5,421	4,430	5,454

Source: *Receipts Budget, Annexure 9*.

any case claimed to occur only with time. Thus it must be on stabilisation that the current economic programme must be judged.

In Table 2 are presented some performance indicators for the Indian economy over the past three years. Clearly inflation is down, and even though the annual average figure for 1992-93 is yet high the monthly inflation rate (figures not provided here) is falling. It is however apparent that this decline is due to improved agricultural performance reflected in a declining relative price of agriculture (foodgrains). The slow growth of industry in 1992-93 has obviously helped too, for notice (Table 2) that the growth in agricultural (foodgrain) production (provisional) for this year exceeds that of the growth in industry (recorded April to October).

But the most disappointing figures are those for the external sector. They point to a disappointing progress of the stabilisation programme with regard to the current account. This must now call into question the entire purpose of the fiscal correction. The two principal counts on which the latter has been rationalised are its ability to correct the trade deficit and to rein-in the inflation rate. The first objective has not been achieved. As regards the very considerable improvement in the current account during 1991-92 it is quite likely due to the severe import compression measures put into effect in that year. The current account worsens in 1992-93 despite the revival of positive inflow on 'invisibles' account. As for the second objective, notice that the relation between the fiscal deficit and the inflation rate is hardly as simple as all that. Over these past two years (Table 2), first a savage cut in the fiscal deficit is associated with a higher inflation rate, then a mild reduction in the former is associated with a decline in the latter. I have already spoken of what must most likely have brought the inflation rate down. It must, of course, be granted that over the medium term accounted for by the last three years the lowering of the fiscal deficit has had the effect of lowering government borrowing and thus the rate of growth of public debt. However, not only is this process not steady in that borrowing is actually up this year, but also external borrowing is up by about 20 per cent (Table 3) in the budget. Three budgets have been unable to bring about a reduction in our external dependence. This represents a weakness. It must also draw attention to the weak link in the present government's strategy, the dependence on external borrowing in the absence of an export strategy.

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