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SN Misra
Director, School of Leadership & Prof. Economics & Law
KIIT University, Bhubaneswar, Odisha, Pin-751024

Sanjaya Ku. Ghadai
Executive, School of Leadership
KIIT University, Bhubaneswar, Odisha, Pin-751024

Correspondence
SN Misra
Director, School of Leadership & Prof. Economics & Law
KIIT University, Bhubaneswar, Odisha, Pin-751024

Fiscal stability, finance sector reforms and budget 2016-2017

SN Misra, Sanjaya Ku. Ghadai

Abstract
Budget 2016-17 had a do a tight rope walk between adherence to FRBM targets and bolstering our GDP momentum, by loosening the deficit targets. It has happily trodden the fiscal consolidation path while showing sensitivity to farmers' plight, providing LPG connection to BPL families and restoring allocation in ICDS. The paper brings out the genesis of the increasing thrust towards containing fiscal deficits, poor progress on financial sector reforms promised in the last budget, dichotomy between governmental amnesty for tax defrauders while taxing low paid employees for PF withdrawal and tokenism in allocation to the education sector. The paper makes a strong case for building a synergy between the Centre and the States in areas like labour laws, acquisition of land to ensure success of manufacturing zones and Sagarmala project to stitch our coast line. The growth process, must not emasculate institutional independence of monetary institutions, must pay due attention to quality in primacy education and abdicate the tendency to pass on the buck to the RBI, for ushering growth.

Keywords: FRBM, GDP, LPG, BPL, ICDS

Introduction
Dr. Manmohan Singh, in his budget speech (1991-92) had quoted Victor Hugo, who wrote "Nobody can stop an idea whose time has come". The NDA government's march towards market fundamentalism and the budget of 2016-17 seem to resonate this resolve. Mr. Arun Jaitley was sandwiched between a choice of following the fiscal discipline of the FRBM Act or to unleash the growth momentum; what Keynes called "revive the animal spirits". The NDA government has chosen to be fiscally prudent and politically wise by increasing allocation in MGNREGA 10%, providing cooking gas cylinder to the BPL families, showering largesse on the Gram Panchayats and harping on the farmer's welfare. In one sweep Mr. Jaitley had done a DiCaprio on India's political celluloid. This paper seeks to examine (a) the genesis and justification for sticking to deficit targets (b) India's progress on financial sector reforms and (c) dark contour of the Voluntary Disclosure Scheme and (d) tokenism towards social sector outlays.

The Deficit Targets
The Maastricht Treaty (1991) had underlined the need for fiscal discipline and put a ceiling of 3% as fiscal deficit for its member states. This was hailed as a major fiscal consolidation initiative, since most countries show a predilection towards profligacy by pandering to populism. The debt crisis in Greece was reflective of this tendency towards high public indebtedness. India is also witness to similar populist tendencies, at the hands of Ms. Gandhi's with loan melas after bank nationalization and waiver of firm loans to the tune of 63000crore during the UPA regime. Such profligacy had ballooned India's fiscal deficit to unacceptably high levels; warranting enactment of the FRBM Act in 2003-04.
However, the target fixed has been subject to frequent revision/slippage under myriad pretexts, like global financial crisis 2007-08. Mr. Jaitley was guilty of such slippage in the last budget but has wisely chosen to be fiscally conservative this time.
The following table will bring out the details of India's debt & revenue collection path in the medium term.

Table 1: Medium Term Fiscal Policy Statement

Parameter	2014-15	2015-16	2016-17	2017-18
Revenue Deficit as % to GDP	2.9	2.6	2.4	2.0
Fiscal Deficit as % GDP	4.1	3.9	3.5	3.0
Gross Tax Revenue	9.9	10.3	10.5	10.7
Total Outstanding Liability to GDP	46.8	46.1	44.7	42.8

Source: India Budget 2016-2017

It may be recalled that the Reinhart-Rogoff Theorem (2010) had brought out how countries with 30% total debt witness handsome positive economic growth of 4 to 4.5%, while those with a total debt liability of more than 90% are likely to countenance negative growth trends. This theorem had obviously irked the western commercial bankers who are constantly on the lookout for lending to vulnerable countries with harsh conditionality. However, the Greek crisis (2013-15) has vindicated the Rogoff theorem. Mr. Jaitley's endorsement of fiscal prudence is, therefore, timely.

However, the grim realities of agrarian distress, inadequate momentum in our Make-In-India initiative and sharp fall in our exports are deeply worrisome. The Economic Survey brings out these trends.

Table 2: Trends of Growth: GDP, Agriculture, Manufacturing and Exports

Parameter	2013-14	2014-15	2015-16
GDP	6.6	7.2	7.6
Agriculture	4.2	-0.2	1.1
Manufacturing	-0.8	2.3	3.1
Services	7.8	10.3	9.2
Export Growth	4.7	-1.3	-17.6

Source: Economic Survey 2015-16

The upward trajectory in our GDP growth is largely due to our service sector, which accounts for 59% of GDP and shows an average growth of 9%. However, the agricultural sector has been at the loose end of this success script. This is largely due to a drop in yield by -1.5%, decrease in area under cultivation by 3.1% and most importantly due to the scant attention paid to provide public irrigation to nearly 60% of our arable rain fed areas. A FAO study brings out the impact of irrigation and other inputs like seeds, pesticide and credit on productivity. The following table will bring out the details.

Table 3: Impact of Irrigation and Inputs

Types of Crop	Cereal/KG/Hectre
Rain fed/Low Input	1000
Rain fed/Optimal Input	2000
Irrigated Low Input	5000
Irrigated High Input	7500

Source: FAO 2005

It would be seen from the above that irrigation with proper inputs can increase yield by 7.5 times of non-irrigated land. The other area that needs urgent attention is the need to undo the animus against genetically modified crops. In a perceptive article Kiran Mazumdar-Shaw brings out that there is an urgent need to set up a Biotechnology Regulatory Authority to encourage indigenous innovation in genetically modified products. She brings out how we are encouraging foreign companies to innovate in India while constraining Indian innovators from bringing indigenous technologies to the farmers.

Mr. Gurumurthy in an engaging article in the Hindu has drawn reference to the (a) futility of Maastricht Treaty (1991) where the 3%. FD cap was hardly adhered to and (b) how there is an inverse relationship between credit growth and fiscal deficit warranting a relook at our monetary policy. This calls for a careful analysis of the trend of macroeconomic data, theoretical underpinnings that divide economists and the way forward. The following table brings out the major macroeconomic trends.

Table 4: Credit, FD & Repo Rate: Trends

Parameter	12-13	13-14	14-15	15-16
Bank Credit (% Change)	14.1	13.9	9.0	11.3
Fiscal Deficit to GDP	4.9	4.5	4.0	3.9
Repo Rate	7.5 – 8	7.25 – 8.0	7.25 – 7.75	6.75
CPI	10.2	9.5	5.9	4.9

Source- Economic Survey & RBI)

It would be seen that quite clearly bank credit shows a decelerating trend; while fiscal deficit has been largely contained. The RBI Governor has also wisely reduced the repo rate by 1.25% during 2015 in view of CPI showing a downward journey. It's a big relief that even food inflation is inching towards the reasonable target of 4%, set by Urjit Patel Committee. However, it would be wise to stick to deficit targets, based on the experience in Brazil, one of the rising stars of Latin America under Lula which is now running a fiscal deficit of -6%, fall in GDP by -3% and a rising CPI by 9.5%. This is due to their fiscal profligacy.

Financial Sector Reforms

After the global financial crisis (2007-09) the USA government brought in the Frank Dodd Act 2010 which underscored the importance of (a) increasing the Cash Adequacy Ratio (CAR) for banks as they were indulging in speculative investments, (b) improve their leverage by increasing equity compared to debt. The budget 2015-2016 unveiled a slew of financial sectors reforms like (a) a new and effective bankruptcy law (b) Indian Financial Code to protect consumer interest (c) Public Debt Management Authority (PDMA) and (d) merge SEBI with the Forward Market Commission (FMC). Of these initiatives, only SEBI has since been merged with Forward Market Commission.

However, what is most distressing has been the slow pace of recovery of NPAs of PSBS, high incidence of stalled projects, and large increase in leverage of the large corporate. The following table brings out these concerns.

Table 5: Trends of Stall Project, NPA, ROA & Debt/Equity

Parameter	2009-10	2015-16
Stalled Projects as % of GDP	6	7.9
Debt Equity Ratio	0.78	0.95
Non-Performing Assets	2.1	5.1
Return on Assets (Banks)	0.9	0.5

Source: Economic Survey -15-16

It would be seen that the twin toxicity viz. high percentage of projects, suffering from time and cost overrun and disproportionately high % of nonperforming assets of the public sector banks are queering investment momentum. The total amount of outstanding dues to PSBs by the large corporate stand around is 4.1 lakh crore. The Debt Recovery Tribunals have been dilatory and ineffective in recovery. The courts have has also not helped matters. One of the parameters, pulling India down in Ease of Doing Business is the unduly long time being taken (>4 years) to resolve contract disputes as per the World Bank study. The draft bankruptcy law which is under circulation must be put into effect urgently as it sets clear time limits to settle disputes and initiate recovery and seeks to exclude involvement of multiple agencies and eschew dilatory methods.

The area in which government is trying to put a noose around the RBI is by constituting a Monetary Policy Committee where there would be large representation from the Ministry of Finance. This is an extremely disturbing trend as the government is trying to emasculate the institutional independence of the RBI in determining the repo rates. The greatest banker Alan Greenspan observes in his seminal book "Age of Turbulence" how institutional independence and professionalism have stood USA in good stead.

Tokenism in Social Sector Allocation

One of the biggest disappointments of last year's budget was the inadequate allocation to major social sector programmes. However, the present budget has made amends on its social sector insensitivity by providing for higher allocation in ICDS and Swachh Bharat. The following table would bring out the trends.

Table 6: Trend of central allocation to social sector schemes (Rs. Cr.)

Scheme	2014-2015	2015-2016	Change %	2016-2017	Change %
ICDS	16519	8599	-48	15872	+85
Swachh Bharat	11938	6000	-49	9000	+50
SSA	15313	19800	+29	22500	+14
MDM	6395	7775	+22	9700	+25

Source-Budget 2016-2017

However, it must be mentioned the allocations against ICDS is lower than the allocation in 2014-15 and needs higher allocation. It must be remembered that this is the fulcrum of a social inclusion scheme where 14 lakh Anganwadi Centres provide basic nutrition care to 7 crore children and 1.5 crore lactating mothers.

The other area that needs urgent attention is the quality of primary education where the budget simply does not allocate enough. Budget 2016-17 has announced establishment of 62 Navodaya Vidyalaya and setting up a High Education Financing Agency with a corpus of Rs.1000crore. This clearly overlooks the kernel of the problem which afflicts the education in primary school. The ASER (2014) clearly brings out how the inadequate numeracy ability, low language skills in English, and high dropouts show no signs of improvement during the last 6 years after RTE Act was enacted. The report also brings out how nearly 30% of the parents opt for private schools paying exorbitantly high fees. This is further exacerbated by no increase in real allocation both in school and higher education.

Table 7: Trends in Central Spending on Education (Rs. Cr.)

Parameter	2014-15	2015-16	2016-17	% increase
School Education	45722	42186	43554	+3
Higher Education	23152	25399	28840	+14
Total	68874	67585	72394	**+7**

Source: India's Budget Document 2016-2017

It would be seen from the above that the overall increase in allocation would be able to take care of inflation and is a far cry from the kind of allocation that is required to improve the human development index of this country. In contrast most developed and EMEs spend close to 5% of their GDP while India continues to provide only 3.3% of its budget to education. The social sector spend would be a critical complement to Digital India and our resolve to be a global manufacturing hub.

Concluding Thoughts

Most analysts seem to feel that the budget 2016-17 is transformative and inclusive. While it must be admitted that it has brought to centre stage the centrality of farmer's welfare, provision of adequate allocation for irrigation, sustainable management of ground water resources, its potential to provide momentum to the National Manufacturing Zone Policy (2011) and the Sagarmala Projects (2015) remain suspect. The dissonance between the Centre and the States on fundamentals like flexible labour laws, acquisition of land for infrastructural needs, GST remain the vital bottlenecks. The facile concern towards improving quality primary education make India's journey towards holistic development even more uncertain. Foisted on this is the toxicity of corporate greed, large defaults by corporate, unduly dilatory resolution mechanism and a tendency to manipulate institutional independence of RBI. Democratic governance is not synonymous with crony capitalism but has to pay greater attention to fostering competition, bolstering positive regulation and protecting the vulnerable by providing adequate social security provisions. Mr. Jaitley and Mr. Prabhu in their budgets have underscored the importance of long term investment in roads, railway modernization and developing a good bond market. These are welcome trends. Three hurdles however, persist; one the tendency to push on the buck for growth to the RBI, budgeting in driblets and an obstreperous opposition. Mere rhetoric would not cut the ice.

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