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## ighlights

- Real and Nominal GDP growth assumed at 6.5 and 10.05 per cent respectively in 2009-10
- Revenue deficit projected at 4.8 per cent of GDP in 2009-10
- Fiscal deficit projected at 6.8 per cent of GDP
- Total expenditure increased by 36 per cent to Rs 10,208.38 billion over 2008-09 (BE)
- IIFCL to refinance 60 per cent of commercial bank loans for PPP projects in critical sectors over the next 15-18 months
- Allocation to National Highways Authority of India (NHAI) for the National Highway Development Programme (NHDP) increased by 23 per cent over 2008-09 (BE) in 2009-10
- Allocation under Jawaharlal Nehru Urban Renewal Mission (JNNURM) stepped up by 87 per cent in 2009-10 over 2008-09 (BE)
- Allocation under Accelerated Power Development and Reform Programme (APDRP) increased by 160 per cent
- Target for agriculture credit flow set at Rs 3,250 billion for the year 2009-10 (credit flow had been at Rs 2,870 billion in 2008-09).
- Rebate for farmers paying loan on time at a lower rate of 6 per cent proposed. Also, deadline for farmers to repay 75 per cent of the loan extended by 6 months to December 31, 2009
- Allocation under National Rural Employment Guarantee Scheme (NREGS) increased by 144 per cent to Rs 391 billion in 2009-10 over 2008-09 (BE)
- Allocation for Bharat Nirman increased by 45 per cent in 2009-10. Under it, allocation under Pradhan Mantri Gram Sadak Yojna (PMGSY) and Indira Awas Yojna increased by 59 per cent and 63 per cent, respectively
- Allocation under National Rural Health Mission (NHRM) increased by Rs 20.57 billion over the allocation in Interim budget 2009-10 (Rs 120.7 billion)
- The overall Plan budget for higher education is to be increased by Rs 20 billion over the Interim Budget
- Unique Identification Authority of India (UIDAI) to set up online data base for Indian residents and provision of Rs 1.2 billion made for this in the budget
- While retaining at least 51 per cent government equity stake in PSUs, disinvestment proceeds for B.E. 2009-10 estimated at 11.2 billion
- Fringe benefit tax (FBT) to be abolished
- Commodity transaction tax (CTT) to be removed
- Minimum alternate tax (MAT) to be increased to 15 per cent of book profits
- Exemption limit in personal income tax raised by Rs 10,000 for all categories of individual taxpayers; by Rs 15,000 for senior citizens
- Surcharge of 10 per cent eliminated on personal income tax

## Detailed economic analysis

### Impact on Indian Economy

#### Introduction

The 2009-10 Budget has been presented against the backdrop of extremely challenging times. The weakness in the global economy is expected to continue through 2009. IMF expects the global economy to contract by 1.3 per cent in 2009, with a number of advanced economies experiencing the deepest recession in the post World War-II period. The World Bank has an even gloomier outlook of -2.9 per cent for the world economy. This has adverse implications for India's exports and capital inflows, and hence, its growth, which has already slipped from the highs of 9.0 per cent to 6.7 per cent in 2008-09. Had it not been for the government stimulus, the fall in growth would have been sharper. In this scenario, another expansionary fiscal policy is essential to push up growth; however, mounting deficits impose limits on government's ability to do the needful.

#### Outlook 2009-10: Down but not out

Despite the policy measures announced in the budget, the India's economic growth is unlikely to exceed 6.5 per cent in 2009-10, given the prevailing global economic slowdown. We expect the economy to grow by 6.0-6.5 per cent at factor cost in the current fiscal as compared to 6.7 per cent in 2008-09. However, recovery, albeit slow, is already underway, and the economy is expected to grow by 6.0-6.2 per cent in the first half of the current fiscal as compared to 5.8 per cent in the second half of 2008-09. The expenditure plans announced today will support the growth momentum. The private sector should see a revival in the second half of the year, when the economy is likely to grow by 6.4-6.6 per cent.

**Table 1: Indian economy in 2009-10**

	2009-10
<b>Real GDP factor cost (y-o-y percentage growth)</b>	6.0-6.5
<b>Supply-side</b>	
Agriculture	3.5
Industry	4.2
Services	8.2
Hotels, transport and communications	7.1
Finance	8.4
Community and social	10.1
<b>Demand-side</b>	
Private final consumption expenditure	5.5
Government final consumption expenditure	15.0
Gross fixed capital formation	3.0
<b>Other macroeconomic variables</b>	
WPI inflation (average)	1.5-2.0
Interest rate (10-year G-sec March-end)	6.4-6.6
Exchange rate (Rs-\$ March end)	47.0-47.5
Fiscal deficit	6.8-7.0

Note: Industry includes mining and quarrying, manufacturing, electricity, gas and water supply, construction

Source: CRISIL assessment

## Detailed economic analysis

Growth in the services sector, which accounts for nearly 57 per cent of the GDP, is expected to decelerate from 9.7 per cent in 2008-09 to 8.2 per cent in 2009-10, as demand weakens further. Industrial growth is expected to remain weak at 4.2 per cent (vis-à-vis 3.9 per cent in 2008-09) due to demand constraints - both exports and domestic - with the financing crunch continuing at least in the first half of the year.

With the several social and infrastructure initiatives announced in the budget, government expenditure would continue to be the key demand driver in 2009-10, although its growth will moderate from 2008-09 levels. Government expenditure is projected to expand by 15.0 per cent in 2009-10. Investment activity is expected to slow further, with gross fixed capital formation growing at 3.0 per cent in the next fiscal as compared to 8.2 per cent in 2008-09. Both weak demand and financing constraints would hit corporate investment. With corporate profits shrinking and other sources of finance drying up, the supply of funds is expected to be tight. Private consumption growth, however, should recover to around 5.5 per cent from a mere 2.8 per cent last year, with several incentives announced to push household expenditure and also due to the lagged impact of interest rate reductions on retail loans.

Among other macroeconomic indicators, inflation would continue to fall in the first half of 2009-10 as prices of commodities, especially oil, are expected to stabilise at a relatively low level due to the global slowdown. The high base of last year and demand slowdown has started to exert downward pressure on prices with headline inflation in the negative zone at present. In the latter half of the year, inflation should start picking up as demand recovers. We expect average WPI inflation to remain in the 1.5-2.0 per cent range. While the steady infusion of liquidity by the RBI as well as a decline in credit demand by the private sector should keep interest rates at a moderate level, the increased government demand for funds to finance its deficit and a pick up in inflation towards the end of the fiscal would pressurise interest rates in the current fiscal.

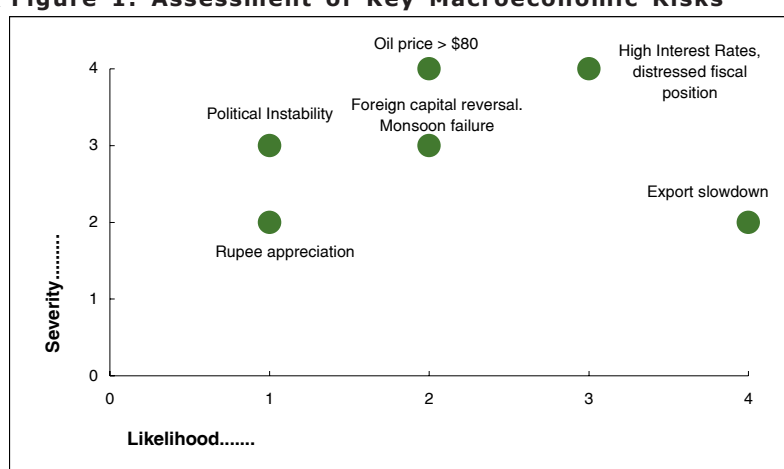
In recent months, the Rupee has recovered some ground with foreign investments flowing back in the country in the first quarter of the current fiscal; the currency is expected to resume its fundamental trend of appreciation. We expect the Rupee to stabilise in the range of Rs 47.0-47.5 per US\$ by March-end. The margin of error for the exchange rate forecast remains high in view of the continuing global financial instability. On the fiscal front, given the current environment, the government has pushed ahead the FRBM target. With further significant fiscal stimulus announced in the budget and the implementation of the remaining part of the sixth pay commission pay hikes, the fiscal deficit would remain under pressure. The good news is that oil, food and fertiliser subsidies and off-budget liabilities are expected to reduce considerably this year. Tax revenues would suffer as economic growth, and hence, tax buoyancy would be lower, although disinvestment and revenues from the auction of 3-G spectrum should bring in additional revenues. Assuming that all the expenditure and revenue proposals in the budget materialise, the fiscal deficit to GDP ratio is expected to be around 6.8-7.0 per cent in 2009-10.

CRISIL macroeconomic forecasts set out here are firmly based on our view of the fundamentals. However, we recognize that the outlook for the world economy is uncertain, given that financial markets continue

## Detailed economic analysis

to be extremely volatile. As a result, frequent revisions to our outlook could become necessary in 2009-10. These revisions would largely be driven by any worsening of the macroeconomic risks and prevailing uncertainty in the Indian economy. From an assessment of the likelihood of alternative risks and their severity, the deteriorating fiscal position and an increased possibility of high interest rates pose the greatest risks to the economic revival at present. A significant deterioration in any of these risks would require a reassessment of the current forecasts.

**Figure 1: Assessment of Key Macroeconomic Risks**



Source: CRISIL Assessment

### Overall fiscal trends

Fiscal performance is contingent on the performance of the economy. The economic downturn took a serious toll on government revenues in 2008-09. The gross revenues of the central government grew by a mere 2.8 per cent in 2008-09 compared to over 25.0 per cent in the preceding year. Income tax and corporation tax growth fell to 7.2 and 10.8 per cent, respectively, from close to 35 per cent in 2007-08. The worst performers were indirect taxes, which shrank by 8.4 per cent in 2008-09. Manufacturing sector is the key contributor to corporation tax and excise duties. With growth in manufacturing slipping to an anemic 2.5 per cent, the poor performance of excise and corporation tax does not come as surprise. Due to the global turmoil, India's external trade performance has been dented considerably, leading to lesser-than-expected growth in customs. Since 1993-94, the service sector's contribution to the government's corpus had been increasing steadily, and service tax collections posted an average growth of 55 per cent per annum in the preceding 3 years. In 2008-09, this sector too has experienced moderation, but growth remains healthy at 18.4 per cent.

While revenues fell short of budgeted targets, expenditures significantly overshoot the budgeted estimates. On the domestic front, adoption of sixth pay commission panel report, National Rural Employment Guarantee act, Farm loan waiver and various subsidies fuelled the domestic expenditure. The global meltdown too impacted India's growth and necessitated further expenditure to cushion falling growth. The impact of

## Detailed economic analysis

global developments can be viewed as two separate developments. The first came from the commodity price shocks in the first half of the last fiscal, which resulted in ballooning of oil, fertiliser and food subsidy bill. The second shock came from the global financial crisis. As the crisis deepened further, government provided some fiscal stimulus largely by reducing different taxes and duties and also raising expenditure.

On the expenditure front, the Government of India (GOI) has achieved significant grip over non-developmental expenditure which had been growing at a high rate till 2002-03. Its annual growth has been brought down to 6-8 per cent. Similarly, non-developmental capital expenditure has also been controlled to a manageable level, although there have been sporadic spurts due to rise in defense expenditure. Table 2 shows the percentage deviation in indicators from the budgeted amount. As is quite evident, fiscal deficit has always been lower than the budgeted estimate since 2002-03 owing to high GDP growth and compression in expenditure. Revenue deficit, which was a cause of worry till 2001-02, had been controlled and reduced, starting with 2003-04. Nevertheless, the fiscal compression has resulted in lesser-than-budgeted growth in plan expenditure in some years. Similarly, non-plan expenditure exceeded the budgeted estimate in the past couple of years. But the extremely favorable GDP growth has reduced the gap between receipts and expenditure. The reversal in 2008-09 is the result of both expenditures which were either not budgeted or not anticipated and revenue hit by lower growth.

**Table 2: Per cent deviation from budgeted**

Year	Fiscal deficit	Revenue deficit	Plan expenditure	Non-plan expenditure	Total expenditure	Gross tax revenue
2001-02	21.2	27.1	6.4	-5.1	-3.4	-17.5
2002-03	-3.1	13.1	-1.8	-2.7	-2.4	-8.3
2003-04	-19.8	-12.5	1.1	9.8	7.4	1.1
2004-05	-8.9	2.8	-9.1	10.0	4.2	-4.0
2005-06	-3.1	-3.2	-2.0	-1.4	-1.6	-1.0
2006-07	-4.1	-5.3	-1.7	5.7	3.4	5.8
2007-08	-15.9	-26.5	0.0	6.8	4.7	8.2
2008-09 RE	145.0	337.2	16.3	21.8	20.0	-8.7

**Source: Union Budget various issues**

The following table presents the key budgetary arithmetic for 2009-10. One of the notable features here is that primary balance (fiscal deficit - interest payments) which was in surplus has turned into deficit in 2008-09 and continues to be in the red in 2009-10.

## Detailed economic analysis

**Table 3: Budget 2009- 10 at a glance**

(Rs billion)	2007-08 Actuals	2008-09 BE	2008-09 RE	2009-10 BE
1. Revenue Receipts	5418.6	6029.4	5621.7	6145.0
2. Tax Revenue (net to centre)	4395.5	5071.5	4659.7	4742.2
3. Non-Tax Revenue	1023.8	957.9	962.0	1402.8
4. Capital Receipts (5+6+7)	1708.1	1479.5	3387.8	4063.4
5. Recoveries of Loans	51.0	45.0	97.0	42.3
6. Other Receipts	388.0	101.7	25.7	11.2
7. Borrowings and other liabilities	1269.1	1332.9	3265.2	4010.0
8. Total Receipts (1+4)	7126.7	7508.8	9009.5	10208.4
9. Non-Plan Expenditure	5075.9	5075.0	6180.0	6956.9
10. On Revenue Account of which	4208.6	4483.5	5617.9	6188.3
11. Interest Payments	1710.3	1908.1	1926.9	2255.1
12. On Capital Account	867.3	591.5	562.1	768.6
13. Plan Expenditure	2050.8	2433.9	2829.6	3251.5
14. On Revenue Account	1735.7	2097.7	2416.6	2784.0
15. On Capital Account	315.1	336.2	413.0	467.5
16. Total Expenditure	7126.7	7508.8	9009.5	10208.4
17. Revenue Expenditure	5944.3	6581.2	8034.5	8972.3
18. Capital Expenditure	1182.4	927.7	975.1	1236.1
19. Revenue Deficit	525.7	551.8	2412.7	2827.4
As a percentage of GDP	-1.1	-1.0	-4.4	-4.8
20. Fiscal Deficit	1269.1	1332.9	3265.2	4010.0
As a percentage of GDP	-2.7	-2.5	-6.2	-6.8
21. Primary Deficit	-441.2	-575.2	1338.2	1754.9
As a percentage of GDP	-0.9	-1.1	-2.5	-3.0

**Source: Union Budget 2009-10**

### Rolling fiscal targets

The Medium Term Fiscal Policy Statement presented along with the budget gives 3-year rolling targets for key fiscal indicators. These have been derived on the basis of assumptions on growth and the policy stance of the government. Table 4 compares the rolling targets set in the budget since 2006-07 and the subsequent revisions in them.

# Detailed economic analysis

**Table 4: Slippage in FRBM targets**

Targets	2008-09	2009-10	Targets for	
			2010-11	2011-12
Fiscal Deficit				
Budget 2006-07	3.0	--	--	--
Budget 2007-08	3.0	3.0	--	--
Budget 2008-09	2.5	3.0	3.0	--
Budget 2009-10	6.0	6.8	5.5	4.0
Revenue Deficit				
Budget 2006-07	0.0	--	--	--
Budget 2007-08	0.0	0.0	--	--
Budget 2008-09	1.0	0.0	0.0	--
Budget 2009-10	4.4	4.8	3.0	1.5
Tax/ GDP				
Budget 2006-07	11.8	--	--	--
Budget 2007-08	12.3	12.7	--	--
Budget 2008-09	13.0	13.5	14.0	--
Budget 2009-10	11.6	10.9	11.9	12.4
Debt/ GDP				
Budget 2006-07	63.1	--	--	--
Budget 2007-08	58.6	56.0	--	--
Budget 2008-09	59.6	55.7	52.3	--
Budget 2009-10	59.6	61.4	60.1	57.2

**Source: Union Budget various issues**

The rolling indicators set in the 2005-06 budget had targeted the revenue deficit to fall to 1.1 per cent of GDP by 2007-08, but the 2006-07 budget had a more realistic revenue deficit target of 1.5 per cent for the same year. The revised estimates for 2007-08 show an improvement in the revenue deficit over the budgetary target. For the last fiscal, revenue deficit of 1.0 per cent was set down in the budget. Under the FRBM act, the revenue deficit was to be eliminated by the next fiscal. In the 2008-09 budget, the elimination of revenue deficit was pushed forward to 2009-10, but it had aggressively targeted the reduction in fiscal deficit to 2.5 per cent of GDP. The outcome for 2008-09 was a complete reversal of fiscal correction over the last couple of years. The fiscal deficit of the central government (including off budget liabilities) was nearly 8 per cent of GDP in 2008-09 as against the target of 2.5 per cent, which happens to be one of the highest since 1990-91.

We test the feasibility of fiscal targets set for 2009-10 to 2011-12 using a simple spreadsheet model (refer section on medium term fiscal sustainability). The results indicate that although there will be some improvement in fiscal indicators going ahead, the FRBM targets set in the present budget are unlikely to be achieved unless government streamlines its revenue mobilisation together with expenditure controls.



# Detailed economic analysis

**Table 5: Feasibility of three year fiscal targets starting 2009-10**

As a % of GDP	2009-10		2010-11		2011-12	
	BE	CRISIL	TARGET	CRISIL	TARGET	CRISIL
Fiscal deficit	6.8	6.8	5.5	6.4	4.0	6.1
Revenue deficit	4.8	4.8	3.0	4.5	1.5	4.1
Tax/GDP	10.9	10.90	11.9	11.20	12.4	11.6

**Source: CRISIL Simulations and Budget 2009-10 document**

## The revenue arithmetic

### Revenue targets in 2009-10

The economic downturn, particularly the weak industrial performance, has dented government revenues quite severely. The budget assumes a nominal growth of 2.1 per cent in gross revenues in 2009-10 over a moderate growth of 5.9 per cent in 2008-09. This shifts the Tax/GDP ratio from 11.6 per cent in 2008-09 to 10.9 per cent in 2009-10. Table 5 documents the share of major taxes in the gross tax revenues, their performance in 2008-09 and expectation in 2009-10. The weak performance on the tax front assumed in 2009-10 is quite realistic given the continuing economic downturn.

**Table 6: Tax Revenues of Central government**

Tax Heads	% Share	% Growth	
	2008-09	08-09/07-08	09-10BE/08-09
Gross Tax Revenue	100	5.9	2.1
Excise	17.3	-12.3	-1.7
Corporate	35.4	15.1	15.6
Customs	17.2	3.7	-9.3
Income Tax	19.5	19.4	-8.0
Service	10.4	26.7	0.0
Other Taxes	0.1	17.6	6.3
Net tax revenue (Centre)	74.2	6.0	1.8

**Source: Budget 2009-10**

The overall revenue receipts (net to the centre) are budgeted to grow by 1.8 per cent in 2009-10 as against the observed growth of around 6.0 per cent in the previous year. One important change in the structure of tax revenues in the last couple of years has been the emergence of corporate taxes as the single largest component of overall tax collections. Prior to that union excise duty was the single biggest source of tax revenue for the government. Also, now direct tax collections have overtaken indirect tax collections in their contribution to the entire tax kitty.

## Detailed economic analysis

**Table 7: Non Tax Revenues of Central government**

Tax Heads	% growth	
	2009-10 BE (Rs billion)	09-10BE/08-09
Fiscal services	1.5	7.2
Interest receipts	191.7	0.7
Dividends and profits	497.5	25.2
Other general services	76.7	12.7
Social services	6.1	5.0
Economic services	600.4	127.3
Proceeds from divestment	11.2	-
Total non-tax revenue	1402.8	45.8

**Source: Budget 2009-10**

### Economic downturn and tax buoyancy

Higher economic growth, especially if that is propelled by industrial growth, leads to an increase in tax collections for the government. Whether the higher growth is translating into adequately high tax revenue is measured by tax buoyancy. This is expressed as 'percentage change in tax revenues per unit percentage change in tax-base'. When tax-buoyancy is greater than one, it implies that the growth in tax collection has surpassed the growth in GDP.

Table 8 brings home the point. The average real GDP growth in phase-I (i.e., 1993-94 to 1996-97) was 6.8 per cent, followed by 5.2 per cent growth in phase-II (i.e., 1997-98 to 2002-03). Phase-III (2003-04 to 2007-08) witnessed an extremely high growth rate to the tune of 9 per cent per annum. However, during 2008-09, growth has slipped to 6.7 per cent due to poor industry and agriculture performance. A cursory look at the table shows that gross tax buoyancy is higher during the high-growth phase and vice-versa. Income tax buoyancy has moved in line with the GDP growth rate, whereas corporate income tax has remained buoyant even when growth remained subdued until the last phase. Due to poor top and bottomline growth of the Indian corporate sector in 2008-09, corporate tax buoyancy has gone below unity for the first time in 8 years.

Until now, custom duty has been a significant source of revenue for GoI. Moreover, it remained quite buoyant during the high growth phase. But due to sharp contraction in export and import activities in 2008-2009, customs buoyancy has become extremely low. Excise buoyancy has gone below zero in 2008-09 largely due to slump in industrial production and reduction of excise duty by GoI as part of stimulus measures. Service tax buoyancy has come down to 1.8 due to slowdown in activities.

# Detailed economic analysis

**Table 8: Tax buoyancy in different growth phases**

	GDP growth	Gross tax	Tax buoyancy				
			Direct tax		Indirect tax		
			Corporate tax	Income tax	Custom	Excise	Service tax
1993-94 to 1996-97	6.8	1.2	1.3	1.5	1.5	0.7	3.5
1997-98 to 2002-03	5.2	0.9	1.6	1.4	0.2	1.2	1.7
2003-04 to 2007-08	8.9	1.6	2.1	1.7	1.5	0.5	4.1
2008-09	6.7	0.5	1.0	1.3	0.3	-1.1	1.8

Note: Service tax was introduced in 1994-95. Hence, buoyancy for Phase-I is for the period 1994-95 to 1996-97.

**Source: CRISIL estimates**

Tax collections record a sharper increase as compared to the base (GDP) in an economic upturn and post a steeper decline in a downturn. During the recent downturn (1997-98 to 2002-03), the overall tax buoyancy fell from 1.2 to 0.9. It again rose to 1.6 during the recent high-growth phase. The 2009-10 budget expects the tax buoyancy to fall to 0.21, which is much lower than that witnessed during the previous downturn. However, given the severity of current economic downturn, the estimate appears pretty realistic.

## Medium term fiscal sustainability

A welcome feature of fiscal developments in the last couple of years was reduction in the deficit ratios and stability in debt/GDP ratios. With the onset of the global crisis, all this changed for the worse in 2008-09. Weak industrial performance, depressed corporate profits and falling tax buoyancy took its toll on government revenues. The stimulus measures involving tax cuts further depressed government revenues. The expenditure commitments of the government went far beyond what was budgeted due to need to stimulate the economy and also due to populist measures like the farm loan waiver. While the fiscal stress in the near term is inevitable, will the fiscal normalcy return over the medium term? . We attempt to address these medium term fiscal sustainability issues using a fairly disaggregated spread sheet model which captures the impact of cyclical factors of government finances

## Features and assumptions of the model

### Revenues

The revenue performance of the government is not linked to the aggregate growth performance but to its sectoral dynamics. While the buoyancy in industry leads to buoyant revenues, the buoyancy in agriculture has no association with revenue performance. Thus, different sectors have different potential of impacting revenues. Recognising this, the government revenues have been linked to the appropriate GDP base. The corporate and income taxes have been linked to the performance of non-agricultural GDP. The service tax collections are linked to performance GDP in the non-government sector. The second characteristic of revenue performance of the government is that government revenues grow more than proportionately vis-à-vis GDP in an economic up-turn and less than proportionately during a downturn. This is because

## Detailed economic analysis

the revenue generating activities like industry and corporate performance see a significant upturn during the boom phase of the economy and opposite happens during a downturn. The tax buoyancy, therefore, is higher in an upturn and lower in a downturn. In 2008-09 the overall tax buoyancy fell from 1.4 per cent in the previous couple of years to 0.2. It has been assumed at 0.21 in the 2009-10 budget.

### Expenditures

2008-09 was an exceptional year and required additional stimulus from the government to boost GDP growth. For 2009-10, we have assumed the major expenditure categories to grow as projected in the Budget. But after that we have assumed that expenditure growth will revert to its normal trend. The arrears to the central government employees have been assumed not to continue beyond 2009-10. The expenditure on farm loan waiver has been distributed over 5 years (till 2011-12) and has been accordingly assumed in the model. The interest payment component of the expenditure is linked to changes in debt stock and interest rates. The interest payments in any given year are impacted by debt stock and a) interest rates applicable on past debt, b) the administered rates of interest and c) the market determined rates of interest for new debt. The average cost of servicing debt in any given year takes into account the above mentioned characteristics. This average interest rate/cost of debt has applied on the stock of debt to work out interest payments in any given year. The interplay of expenditures and revenues determine the key fiscal indicators like fiscal, revenue and primary deficit.

### GDP growth

Monetary easing and fiscal stimulus by the government notwithstanding, the prevailing global economic slowdown is expected to pull down growth further in 2009-10. We expect growth to slide further in first half of 2009-10, and post a mild recovery beginning in the third quarter. The economy is expected to grow at around 6.0-6.5 per cent in 2009-10. After that, as the global economies recover and the impact of monetary loosening on the economy kicks in, growth in India too will pick up. We expect the economy to expand by 7.2 per cent in 2010-11. After 2011-12 the economy should be on the 8 per cent growth path.

**Table 9: Medium term growth assumptions**

	2009-10	2010-11	2011-12	2012-13	2013-14
Agriculture	3.5	3.0	3.0	3.0	3.0
Industry	4.2	6.5	7.6	8.0	8.5
Services	8.1	8.7	9.4	9.5	9.7
Total GDP	6.3	7.2	7.9	8.1	8.4

**Source: CRISIL**

The model simulations indicate that fiscal stress is likely to continue in the short run with only moderate corrections in fiscal deficit/GDP and revenue deficit to GDP after 2009-10. Even after assuming that trend growth in expenditure will come down from that in 1998-99 and 1999-2000, the deficit levels continue

## Detailed economic analysis

to remain high. The fiscal deficit comes down from 6.2 per cent of GDP in 2008-09 to 5.1 per cent by 2013-14. This is quite similar to the behaviour of fiscal deficit in the most recent up turn in the Indian economy from 2003-04 to 2006-07. The central government deficits were at a high of 5.9 per cent of GDP in 2002-03. Despite an average GDP growth of 8.8 per cent and a sharp rise in revenue buoyancy between 2003-04 and 2006-07, the fiscal deficit came down by only 2.5 percentage points to 3.5 per cent by 2006-07. The revenue deficit too displayed similar pattern during this period. Absence of expenditure reforms was clearly behind sluggish fiscal improvement. We have a somewhat similar situation now.

Bringing the debt/GDP (debt ratio) requires much sharper correction in the fiscal deficit than the forecast in our base case scenario. The good news on the debt front is that it is likely to remain stable at high levels and start reducing after 2010-11. By 2013-14, the debt/GDP is expected to be around 57.0 per cent. The debt dynamics can be understood in terms of the growth, interest rates and primary deficits. As long as the growth remains higher than the cost of borrowing (interest rates), the debt ratio can be kept stable even by running a primary deficit. The current downturn notwithstanding, the structural upward shift in growth rates and a downward shift in interest rates will help in stemming the explosive debt dynamics in future. The average cost of government debt has come down from 7.9 per cent in the eighties to 9.3 per cent in the nineties. It is currently around 6.8 per cent. At the same time, there has been a significant improvement in GDP growth. This gives government some leeway to run a primary deficit and yet maintain stability in the debt ratio. That is why we have stability and eventual reduction in the debt ratio despite primary deficit of around 1.5 per cent of GDP during the 5 years beginning 2009-10. If, however, the GDP growth drops below our assumptions, even moderate fiscal correction will be difficult to achieve.

**Table 10: Fiscal Indicators ( as % of GDP)**

	2009-10F	2010-11F	2011-12F	2012-13F	2013-14F
Fiscal deficit	6.8	6.4	6.1	5.6	5.1
Revenue deficit	4.8	4.5	4.1	3.6	3.1
Primary deficit	3.0	2.7	2.3	1.9	1.5
Interest Payments	3.9	3.8	3.8	3.7	3.6
Debt /GDP	61.4	60.3	59.8	58.7	57.0

**Source: CRISIL Simulations**

The medium-term fiscal policy statement accompanying the budget estimates the revenue deficit at 1.5 per cent and fiscal deficit at 4 per cent of GDP by 2011-12. These are more realistic than the targets set out in the interim budget which was aiming at zero revenue deficit by 2011-12. The total liabilities of the government are projected to fall to 57.2 per cent by 2011-12. We believe these targets are too aggressive and our simulations show that they are unlikely to be achieved. By 2011-12, we expect fiscal deficit, revenue deficit and debt at 6.1, 4.1 and 60 per cent of GDP. A significant rise in tax buoyancy is required to achieve the revenue deficit target 1.5 per cent of GDP by 2011-12 set in the medium term

## Detailed economic analysis

fiscal policy statement. Fiscal projections over the medium run clearly indicate that unless concerted efforts are made for curbing expenditures and or raising revenues, reducing the revenue deficit to 1.5 per cent of GDP by 2011-12 would be a challenging task.

Going ahead, the key issue is related to medium term fiscal sustainability. A key positive development in the last few years has been the slightly disciplining impact of Fiscal Responsibility and Budget Management Bill (FRBM) on government finances. But the sharp growth contraction led to the abandonment of FRBM targets so as to stabilise the economy and to give a boost to consumption.. To restore fiscal credibility, the government needed to come out with a new FRBM Act which takes into account the changed economic scenario. The economic survey had suggested the concept of targeting cyclically adjusted deficit. During a downturn government revenues shrink and expenditures escalate, thereby widening the deficit. The reverse happens during a boom period. So the surplus generated during boom years is used to finance deficit during a recession. Cyclically adjusted deficit takes into account changes in business cycles to work out the underlying deficit which is a normal year deficit. The shape of the new FRBMA will be clear only by October 2009.

### Theme I: What has the budget done for growth?

The Indian economy grew by over 6 per cent during 2008-09 despite depressed domestic and export demand in the wake of severe global economic crisis. What accounted for this robust growth performance as compared to a number of other developing countries is the contribution of government expenditure. It is no surprise that the government has once again announced a number of measures in the budget to sustain the growth rate of the economy in the current fiscal. The budget has provided support to the social and infrastructure sectors in particular.

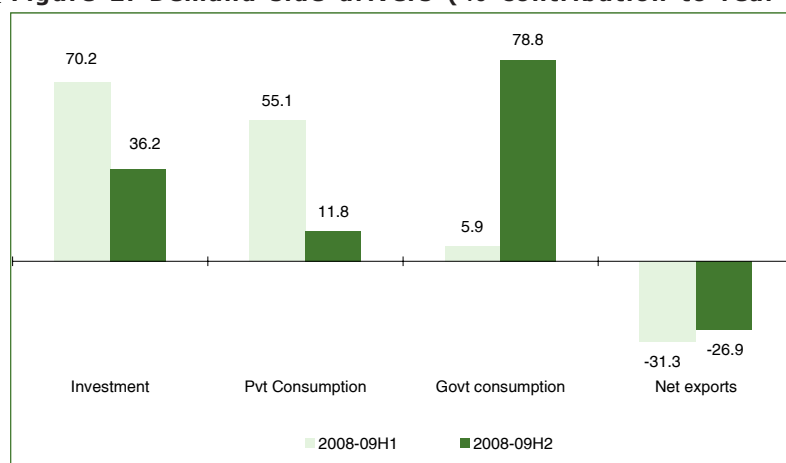
### Demand-side components of GDP (2008-09)

GDP growth from the demand side arises from changes in four main components: consumption expenditures, domestic investment, government consumption expenditures and net exports (difference between the value of exports and the value of imports). The contribution to growth of each of these GDP components- defined as the ratio of the change in that component over 2008-09 to the total change in GDP over same period, expressed as a percentage-pinpoint those components most responsible for additions to GDP.

In 2007-08, government expenditure contributed around 7.6 per cent to overall GDP growth. The contribution of this component to GDP growth increased to a whopping 38.0 per cent in 2008-09 as a result of the fiscal stimulus. In contrast, the contribution of private consumption to Indian growth dropped significantly from just over 50 per cent to around 38 per cent during the same time. Unlike in a number of other countries which are experiencing economic slowdown or recession, investment remained relatively robust, contributing to 57.0 per cent of GDP growth. Lastly, in 2008-09, net exports was a drag on the GDP as real exports fell faster than imports as oil import bill ballooned in the first half of 2008-09.

## Detailed economic analysis

**Figure 2: Demand side drivers (% contribution to real GDP growth at market prices)**



Source: CRISIL Estimates fom CSO data

The role of increased government expenditure in boosting GDP was especially significant in the second-half of 2008-09 as the global economic crisis deepened. Almost 80 per cent of GDP growth in the second half of last year resulted from an increase in government expenditure (Figure 2). In contrast, the contribution of investment and especially that of private consumption to growth dropped drastically in the same time period. Another impact of fiscal stimulus, as reflected in higher subsidies and reductions in taxes was seen in the difference between GDP at market prices and GDP at factor cost in the second half of last year. While GDP at factor cost grew at 5.8 per cent during October-March 2008-09 GDP at market prices grew only by 4.45 per cent during the same period. In other words, net subsidies amounted to almost 1.35 per cent of GDP.

### Growth drivers - 2009-10

#### 1) Private consumption

During the 4 years of accelerated growth between 2004-05 and 2007-08, increase in private consumption made the most important contribution to aggregate demand. But the picture changed dramatically during 2008-09. In the first half, the monetary tightening measures by the RBI to control inflation and inflationary expectations pushed up the cost of borrowing. In the second half, the sharper-than-expected global slowdown had an impact on employment and income growth, especially in export-oriented sectors. As a result, private consumption growth slowed down considerably in 2008-09.

The budget of 2009-10 aims to stimulate private consumption by increasing plan expenditure by Rs 400 billion over and above that was announced in the interim budget in February. A large portion of this outlay would be channelled through schemes such as National Rural Employment Guarantee Scheme (NREGS) and Jawaharlal Nehru National Urban Renewal Mission (JNNURM). The enhanced provisions for these schemes are aimed at boosting demand and generate employment in the domestic economy. In addition,



## Detailed economic analysis

an increase in the threshold level for paying income tax by Rs 10,000 for general taxpayers, and by Rs 15,000 for senior citizens would raise disposable income, albeit marginally. The removal of the 10 per cent surcharge on income above Rs 10 lakh for personal income tax payers should also encourage consumer spending. However, In spite of these measures, private consumption growth is unlikely to recover significantly in the current fiscal as job and income uncertainty continues. In addition, interest rates on retail bank credit have not come down to the level necessary to boost household consumption.

### 2) Government consumption

In the second half of 2008-09, the government effectively used the fiscal policy as a tool to provide a boost to domestic demand and counter the negative impact created by the global financial crisis. Government expenditure is once again expected to be a leading growth driver in the current year. Total expenditure of the Central government is budgeted to increase by Rs 1,199 billion or by 13.3 per cent y-o-y, primarily on account of higher plan outlay to boost domestic demand and increased food subsidy

Until 2007-08, the most encouraging feature of government finances was an improvement of government savings and the increasing fiscal responsibility it exhibited. The pattern altered completely last year. As noted in the previous section, given the large size of stimulus already underway and more under consideration, importance of a clear commitment to long-run fiscal discipline is critical. In the absence of such a perceived commitment, expansionary fiscal actions can lead to increases in long-term interest rates, which would tend to offset the stimulus effects of the fiscal actions on GDP.

### 3) Investment

The trend of investments in the economy rising in tandem with the GDP has been a prominent feature of India's growth story. In the last fiscal, however, investment growth, although robust, slowed down from a peak of nearly 19.0 per cent in 2004-05 to just over 8.0 per cent, as financing constraints and depressed demand compelled companies to revise their investment strategies. The improvement in investments in recent years has been driven by a significant increase in the private corporate sectors investment, largely funded via retained earnings, which has doubled as a share of GDP within 4 years - from 6.8 per cent in 2003-04 to 15.9 per cent in 2007-08. The current slowdown is likely to hit corporate investments, going forward.

In light of the slowdown in growth of private investment, the budget announced a number of key initiatives to increase public sector investments, especially in infrastructure sectors such as highways and railways as well as urban infrastructure. The increased government spending, although necessary at this juncture, has further weakened the government's fiscal position. The current deterioration of the public sector finances could have an adverse impact on corporate investment going forward, if a definite plan to reduce fiscal deficit is not in place. Earlier in this decade, private corporate sector investment had soared after the public's saving records started to improve and freed up resources for private investment and also brought down the cost of borrowing.



## Detailed economic analysis

### 4) Trade

India's external sector also witnessed a significant contraction in export and import growth in the second half of 2008-09 as the global economic crisis spread and world international trade started to contract. In spite of the government measures announced in the budget to support the export sector, such as provision of enhanced export credit and guarantee cover and the extension of the interest subvention of 2 per cent on pre-shipment credit for certain export sectors, trade contraction is likely to persist in the current fiscal year due to shrinking global trade activity.

### Summary assessment

The government has announced several initiatives in the budget aimed at raising private consumption and investment to revive the economy in the uncertain global economic environment. However, government consumption would continue to be the key driver of economic growth in the current fiscal year.

### Theme II - Infrastructure - Where are we?

Weakness in the global economic environment, and its adverse impact on exports and domestic consumption, has led to a renewed focus on the infrastructure in the economy. In the last few years, the government introduced various schemes to promote and facilitate physical infrastructure in the country across energy, communication, transport etc sectors in both urban and rural areas. But the pace of infrastructure growth in the country remained much lower than the requirements. As infrastructure has a direct bearing on domestic economic production and services, it has immense capacity to stimulate domestic investment and business. Better infrastructure not only enhances accessibility ameliorating supply-side bottlenecks to growth but also helps bring down transaction cost.. Thus, adequate push to the infrastructure sector in the next few fiscal years is considered to be crucial to stimulating domestic demand and investment and in turn growth in the economy.

The deterioration in fiscal health of the government coupled with tight liquidity conditions globally has made financing of infrastructure a very challenging task. Although the total central plan outlay has been increased by 19.3 per cent over the budgeted figure of last fiscal, it is 15.4 per cent higher than the revised figure. Further while the budgetary support is 33.3 per cent higher than budget estimates of the previous fiscal year, it is only 17.5 per cent higher than the revised estimates. But, unlike the previous fiscal, this year the incremental support has come from the budget, and not the internal and extra budgetary resources (IEBR). Table 11 below shows the rise in outlay in terms of both IEBR and budget support to the major ministries covered under the physical infrastructure segment.

# Detailed economic analysis

**Table 11: Year-on-year growth in plan expenditure**

	2008-09 RE			2009-10 BE		
	Budget Support	IEBR	Total	Budget Support	IEBR	Total
Ministry of Power	40.23	14.68	18.30	51.31	45.32	46.33
Ministry of Shipping	-37.12	4.85	-3.06	64.38	71.60	70.71
Ministry of Road Transport and Highways	7.61	77.03	17.55	14.87	35.14	19.24
Ministry of Urban Development	54.59	30.35	44.69	-34.20	-17.86	-28.19
Ministry of Housing and Urban Poverty All	34.00	-28.32	-23.39	26.87	61.14	56.40
Railways	14.85	22.51	20.42	56.53	-6.48	9.85
Total	18.67	20.31	19.75	26.69	22.24	23.75

Note: Revised estimates of 2008-09 compared with revised estimates of 2007-08.

Budget estimates of 2009-10 compared with revised estimates of 2008-09.

Note: IEBR = Internal and Extra Budgetary Resources

**Source: Calculated from Budget 2009-10.**

## A) Urban infrastructure

Besides direct outlays to the ministry of transport, railways, power etc, the chief vehicle of the government to boost infrastructure development in urban areas is the Jawaharlal Nehru National Urban Renewal Mission which is administered jointly by Ministry of Urban Development and the Ministry of Housing and Urban Poverty Alleviation launched in 2005-06, the scheme's objective is to enable cities to provide and improve governance of their civic services entailing water supply, transport, waste management etc. A total of Rs 1 trillion (Rs 500 billion from the Central assistance and equal amount from state governments and urban local bodies) has been made available for this purpose since 2005-06 for a period of 7 years. JNNURM has been a particularly successful scheme and has been instrumental in driving reforms in urban governance and urban-related laws. For this reason, the new budget has enhanced the allocation to the JNNURM by 87 per cent over 2008-09 (BE) to Rs128.8 billion. There are several sub-missions under the umbrella of JNNURM that encompass development in small and medium sized towns and public-private partnerships across sectors. Metro-rail projects in Delhi and other cities such as Kolkata and Bangalore, Bus Rapid Transit systems in major Tier 1 & Tier 2 cities etc. are examples of projects covered under the scheme. Fresh initiatives under the scheme include comprehensive land titling legislation in Rajasthan, creation of a municipal accounts service in Andhra Pradesh, setting up of urban transport in Surat, and setting up of transport authority in Hyderabad, Jaipur, Chennai, Bangalore and Mumbai.

## B) Power

The National Electricity Policy, 2005, recognises electricity as a "basic human need" and targets a rise in per capita availability from 704 units in 2007-08 units to 1,000 units per annum by the end of 2012 - that is a capacity addition of 78,700 MW as set under the Eleventh 5-Year Plan. However, in both Ninth and Tenth 5-year Plans, the capacity additions were way behind target. Even in 2007-08, the capacity addition of 9,263 MW was 23 per cent lower than the revised (downward) target for the year. In spite of significant past reforms and impending high targets, energy generated by power utilities (2.7 per cent)

## Detailed economic analysis

fell short of the target 9.1 per cent growth in 2008-09. All-India peak shortage declined during the year, but that was primarily due to lower growth in peak demand. These trends underscore the urgent need to address the supply-demand imbalance and call for further reforms and fiscal allocations in the sector. The primary reasons for underachievement of capacity addition targets during the last 2 years were delayed and non-sequential supply of material by suppliers, shortage of skilled manpower, construction and commission of projects etc.

To address these constraints, the new budget has raised the total plan outlay for the sector by 51.3 per cent along with a hike of 45.3 per cent in the IEBR, compared to the revised estimates of previous year's expenditure. As such, last fiscal year's revised estimates of the expenditure by the Ministry of Power was 10 per cent lower than the budget. Allocation under the Accelerated Power Development and Reform Programme (APDRP), an important scheme for reducing power demand and supply gap was raised to Rs 20.8 billion, 160 per cent more than the last year's allocation. However, the budget did not focus on the sector to any great extent.

### **C) Road transportation**

The new budget has stepped allocation to the NHA for the NHDP by 23 per cent over the 2008-09 (BE). National Highways (NHs) account for about 40 per cent of the total traffic on Indian roads. However, they comprise only about 2 per cent of the total length of roads, which underscores the massive need for NH development. The National Highway Development Programme (NHDP) to construct 33.6 thousand kilometres is under implementation; of this, 32.8 per cent has been completed and 18.4 per cent is currently under implementation. Majority of the completed project comes under the Golden Quadrilateral, with nearly 98 per cent having been completed by March 2009. The other major project is the North-South & East-West Corridor project, which was 48 per cent complete by March 2009, and is expected to be finished by December 2009. It also covers the SARDP-NE, a programme devised to improve road connectivity in the North Eastern region. Its first phase -targeted for completion by 2012-13 - consists of improving 2619 km of road including primarily NHs. The NHDP also includes upgradation of already developed national highways. The main source of funds for the NHDP under the National Highway Authority of India has been the fuel cess and loans from multilateral organisations. However, implementation of the the NHDP continues to face constraints in land acquisition, removal of structures, shifting of utilities etc.

### **D) Ports and Shipping**

Ports play a critical role in international trade, and consequently, are crucial for economic development. Maritime transport accounts for about 95 per cent of the country's foreign trade in terms of volume and 70 per cent in terms of value. There are 12 major ports and 200 minor/intermediate ports located along the 7,517 km-long coastline of India, with the major ports handling three-fourths of the sea-borne traffic. Significant constraints have emerged in the sector, with the turnaround time being much higher than that of some other international ports. Total traffic carried by both minor and major ports during 2008-09 was about 723 MT. However, despite adequate capacity and modern handling facilities, the average

## Detailed economic analysis

turnaround time on Indian ports was 3.85 days in 2008-09 as compared with 3.93 days in 2007-08 and 3.62 in 2006-07. It falls well below the international benchmarks; for example, in Hong Kong, the average turnaround time is 10 hours. This is due to weak linkages to hinterland that clog up cargo evacuation. All port trusts have set up groups of representatives from NHAI, Railways and State governments to prepare plans aimed at improving rail-road connectivity. The union budget has raised the total outlay to the ministry by a significant 70.7 per cent as against the 54 per cent increase in the 2007-08 budget. Of this, the budgetary support has improved by 64.4 per cent.

### E) Rural infrastructure

Rural infrastructure has gained impetus under the Bharat Nirman scheme that was launched in 2005-06. It contains six components, namely, rural housing, irrigation potential, drinking water, rural roads, electrification and rural telephony. The budget allocation towards the scheme has been increased by 45 per cent in 2009-10 over 2008-09 BE. Under the Pradhan Mantri Gram Sadak Yojana (PMGSY), a successful project under the scheme, a total length of 214 thousand kilometres of roadwork was completed as of March 2009. In 2009-10, the total budgetary allocation has been stepped up by 59 per cent to Rs 120 billion over 2008-09 BE. Under the Indira Awas Yojana (IAY), 2,105 thousand houses were constructed during 2008-09. Given its success, the budget allocation towards this scheme has been augmented by 63 per cent. In addition, an allocation of Rs 20 billion has been made for Rural Housing Fund (RHF) in National Housing Bank (NHB) to boost the resource base of NHB for re-finance operations in the rural housing sector. A new scheme called Pradhan Mantri Adarsh Gram Yojana (PMAGY) has been launched on a pilot basis for the integrated development of 1,000 villages with over 50 per cent scheduled caste population. Rs 1 billion has been provided for this scheme, allowing each village would to avail gap funding of Rs 1 million over and above the allocations under Rural Development and Poverty Alleviation Schemes. On successful implementation of the pilot phase, the Yojana would be extended to 43,000 such villages in coming years.

### Theme III - Inclusiveness

Despite the rising fiscal deficit, the Union Budget 2009-10 has made an attempt to provide steady monetary assistance to the social sector. Focussing on inclusive growth, the UPA government in its interim budget had emphasised on the progress of existing flagship programmes such as National Rural Employment Guarantee Scheme (NREGS), Sarva Shiksha Abhiyan (SSA), Mid-day Meal Scheme, National Rural Health Mission (NRHM) and Jawaharlal Nehru National Urban Renewal Mission (JNNURM) by augmenting their budgetary allocation. In its full budget, the government has only tried to broaden its agenda for inclusive development. However, the government seems to have been rather conservative in allocating funds to the social sector this time as compared to the previous year.

Budgetary support to the social sector, together with internal and extra budgetary resources (IEBR), grew by a mere 10.5 per cent over the revised estimate of 2008-09 (Table 12). As compared to this, according to the revised estimate of 2008-09, allocation to the social sector had grown by 45.0 per cent over the

## Detailed economic analysis

allocation in the previous year. However, as a per centage of total central government plan expenditure, or gross budgetary support (GBS), expenditure on social services and rural development has been budgeted at 45.1 per cent in 2009-10 BE as against 46.5 per cent in 2008-09 RE.

### Employment

**Table 12: Year-on-year growth in plan expenditure**

	2008-09 RE			2009-10 BE		
	Budget Support	IEBR	Total	Budget Support	IEBR	Total
Ministry of Health and Family Welfare	23.04		23.04	18.57		18.57
Ministry of Rural Development	79.75		79.54	10.60	-18.75	7.47
Department of School Education and Literacy	10.41		10.41	9.39		9.39
Department of Higher Education	108.48		108.48	41.17		41.17
Ministry of Women and Child Development	18.25		18.25	7.30		7.30
Total	48.65	20.00	45.02	11.30	3.83	10.52

**Source: Calculated from Budget 2009-10**

While the overall share of expenditure on labour and employment in total social services expenditure has been falling for the last 3 years, the emphasis on employment in rural areas has always been accorded the highest priority. The National Rural Employment Guarantee Act (NREGA), one of the flagship programmes of the government, has been recognised as the most successful programmes ever. The scheme, which was launched on February 2, 2006, in 200 extremely backward districts, was extended to cover all the districts of the country in 2008. The scheme has led to an improvement in wage employment in rural areas, thereby pushing up demand for goods. During 2008-09, employment of 215.63 crore person days covering 4.47 crore households was generated.

The interim budget for 2009-10 had allocated Rs 301 billion for the scheme as against Rs 160 billion in 2008-09. This allocation has further been raised to Rs 391 billion, signalling an increase of 144 per cent over 2008-09 BE. Also, in order to increase the productivity of assets and resources under NREGA, convergence with other schemes relating to agriculture, forests, water resources, land resources and rural roads is being initiated. In the first stage, a total of 115 pilot districts have been selected for this purpose. The Swarna Jayanti Gram Swarozgar Yojana (SGSY), launched in April 1999, was originally meant to bring the assisted self-employees above the poverty line by providing them income-generating assets through bank credit and government subsidy. This scheme has been restructured as National Rural Livelihood Mission to make it universal in application, and aims to eradicate poverty by 2014-15. For the facilitation of job-seekers, there is a proposal to launch a new project for modernisation of Employment Exchanges, so that a job seeker can register on-line from anywhere and approach any employment exchange. A national web portal with common software, to be developed under this project, will contain all the data regarding availability and requirement of skilled persons. It will help youth get placed and enable the industry to procure required skills on a real time basis.

### Education

## Detailed economic analysis

As compared to last year, the budget allocation to education is far from being impressive. The support towards the Department of School Education and Literacy shows a growth of 9.4 per cent over the revised estimate of 2008-09, and that towards the Department of Higher Education shows a growth of 41.2 per cent. As compared to this, last year's growth in allocation stood at 10.4 per cent and 108.5 per cent, respectively.

Among the initiatives taken towards the education sector, the support for the scheme, "Mission in Education through ICT" has been raised from Rs 5.02 billion in 2008-09 to Rs 9 billion in 2009-10. The allocation towards Skill Development Mission has also been enhanced to Rs 4.95 billion. There are various other ambitious proposals, including opening of one Central University in each uncovered state with a corpus of Rs 8.27 billion and setting up of new IITs and NITs with a provision of Rs 4.5 billion. For the welfare of minorities, SC, ST and other marginalised groups, National Mission for Female Literacy is to be launched with the aim of reducing female illiteracy by half in 3 years.

### Health

The budget 2009-10 proposes to increase the allocation to health sector by 18.6 per cent over the previous year. National Rural Health Mission (NRHM), a key initiative by the government with the aim to achieve the goal of health for all, has received an allocation of Rs141.27 billion, 17.2 per cent higher than the allocation in last year's budget. The allocation towards Rashtriya Swasthya Bima Yojana (RSBY), launched on October 1, 2007, for the BPL families in the unorganised sector, has been increased to Rs 3.5 billion, 70 per cent higher than last year's allocation of Rs 2.05 billion.