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Macroeconomics of "NaMo" Budget 2014 in India

Lekha Chakraborty

The present government has inherited an economy characterised by low growth, high inflation, high current account deficit and large fiscal imbalance at the Union level. What has struck me about Union budget 2014-15 is not the fiscal arithmetic, but the macroeconomic framework. One could sense a deal for fiscal-monetary policy co-ordination in the budget speech, especially with the announcement of Finance Minister for a "New Monetary framework". The paper focuses on the macroeconomic framework of the budget rather than dealing with the fiscal arithmetic, in terms of policy announcements and budgetary allocations.

The dynamics between North Block and Mint Road is always challenging, and so far India has witnessed a fiscal dominance, over monetary policy.The announcement by Finance Minister on "new monetary framework" for India needs to be co-read with the advancements in RBI seeking more 'central bank independence' to manage inflation and how it plays out in the macroeconomic context of India in light of the *Expert Committee to Revise and Strengthen the Monetary Policy Framework (*Urjit Patel Committee report).

The underlying macroeconomic framework of the budget revealed two thematic priorities of the present government; (i) growth revival and (ii) macroeconomic stability. This sets the track. The Union budget was simultaneously ensuring a 'continuity' and 'change'. The 'continuity' elements in the budget may be to ensure a bipartisan approach in tackling the issues of national interest, especially in case of fiscal consolidation path of earlier government. However the 'changes' suggested in the budget in terms of new monetary framework is disturbing.

I. Fiscal Consolidation

The growth revival and fiscal consolidation involve conflicts and tradeoffs. The Finance Minister's speech highlighted the significance of fiscal prudence. He was honest in accepting that controlling the fiscal deficit to 4.1 per cent of GDP in the current fiscal is the biggest challenge of the government. The budget set the fiscal consolidation path for medium term, with the aim to reduce fiscal deficit to 3.6 per cent in 2015-16 and 3 per cent of GDP in 2016-17.

Though the Economic Survey highlighted that "India needs a sharp fiscal correction, a new Fiscal Responsibility and Budget Management (FRBM) Act with teeth", budget has not specified anything other than the accepted target of 3 per cent of GDP for fiscal deficit.However, the path of fiscal consolidation was vaguely spelled out that the target would be achieved with increase in revenue buoyancy than expenditure cuts. This is a welcome shift. However regarding the deficit targets, there is not much change in the present budget compared to the previous Interim budget (Table 1).

Table 1: Deficit Targets

	2013-14 RE		2014-15 BE		2015-16 Target		2016-17 Target	
as % of GDP	Interim Budget	General Budget	Interim Budget	General Budget	Interim Budget	General Budget	Interim Budget	General Budget
Effective Revenue Deficit	2.2	2.0	1.8	1.6	0.0	0.0	0.0	0.0
Revenue Deficit	3.3	3.3	3.0	2.9	2.0	2.2	1.5	1.6
Fiscal Deficit	4.6	4.6	4.1	4.1	3.6	3.6	3.0	3.0

Source: Government of India (2013, 2014): Budget documents, Ministry of Finance.

These deficit targets are in conformity with the New FRBM rules adopted in September 2012. The New FRBM envisaged that effective revenue deficit will be eliminated by 2015-16 and the revenue deficit will be controlled to sub-two per cent of GDP within same period.

The path of fiscal consolidation is envisaged differently in the present budget, though the targets are kept the same. The path of fiscal consolidation is set on an optimistic increase in the non-tax revenue estimate from 1.4 per cent of GDP to 1.7 per cent of GDP for 2014-15 (BE). The nontax revenue is expected to rise on the account of dividend from RBI which has been revised by RBI following the new accounting practice recommended by the Malegam panel for the central bank for closure of its Annual accounts in June 2014. It is expected that Rs 46,000 crores will be paid to the government as dividend in 2014-15, as compared to Rs 33,000 crores in 2013-14.

Revenue buoyancy is also expected from the non-debt capital receipts side, the Government has increased the disinvestment target from Rs. 36,925 crore as per interim budget to Rs. 43,425 crore in 2014-15 (BE), with the estimate of divestment of Government stake in non-Government Companies remaining at Rs. 15,000 crore.

The analytical framework of the fiscal consolidation highlighted by the Finance Minister was different from the earlier frameworks. The Finance Minister surprisingly has not highlighted the popular neo classical frameworks that fiscal deficits crowd out private investment or raising interest

rates. Empirical evidence revealed that fiscal deficits do not raise interest rates or crowd out private investment (Chakraborty 2002, 2007, 2008, Chakraborty and Chakraborty, 2006, Vinod, et al 2014) and proved a different discourse of link between fiscal policy stance and output. In the Union Budget 2014 rather what he highlighted as the framework of fiscal consolidation is the "intergenerational debt burden, that today's debt is next generation's tax burden". This is appealing in a sense that government uses the deficit for productive purposes including infrastructure investment which can "crowd-in" rather than "crowd-out" private corporate investment. Whatever be the framework he used, fiscal deficit reduction was given emphasis in his speech by curtailing "mindless populism" as well.

II. New Monetary Policy Framework

Even if for argument sake, we highlight that inflation is the most important obstacle for achieving macroeconomic stability and growth, the question remains. Is inflation strictly a monetary phenomenon in India? There are equally convincing discourses which highlight that supply side shocks determine inflation, in addition to the monetary determinants. The General Budget 2014-15 has identified the need to tackle "price volatility in agriculture", by constituting a Price Stabilisation Fund of Rs 500 crores.However, the Iraq war and bad monsoon instil more supply side irregularities in price determination and the fiscal route to inflation management should have been spelt out more clearly in the budget. Instead, the Finance Minister has emphasised the need for new monetary framework, which is a change, compared to earlier budgets.

In India, we have been accustomed to fiscal policy dominance, and always the first mover advantage in policy making was vested with budget policy makers. What I hint here as fiscal dominance is definitely not the financing of deficits through printing money (which is technically called as 'seigniorage financing of deficits). We have come out of monetising deficits through printing money a few decades back. What I highlight here as a new macroeconomic consensus is the move towards providing more central bank independence in tackling inflation. If so, the framework of this budget raises concern. Is this really a new macroeconomic policy consensus?

Given that the inflation in India during the last decade is the highest among the G-20 countries, it is pertinent to focus on inflation containment, as its macroeconomic consequences in terms of negative real interest rates and falling financial savings, depreciation-inflation spiral and worsening of income distribution (Report of RBI, 2014). However, when there is a growing consensus across nations after the global financial crisis for central banks to move away from single role of price stability towards multiple indicator approach, Urjit Patel's report indicates a move towards inflation targeting in India. This report therefore raises a concern before the new government in terms of the degree of flexibility and linkages between central bank and government, technically the linkages between monetary policy and fiscal policy.

The renewed debates towards independent, inflation targeting central bank has genesis in a series of three reports submitted - Percy Mistry report, 2007; Raghuram Rajan report, 2009 and Financial Sector legislative Reforms Commission report (FSLRC), 2013. These three reports emphatically

directed the policy discourse towards price stability as the primary goal of central bank in India, and Urjit Patel report too forms a part of this camp in terms of monetary policy framework. This trend in monetary policy framework can cause a concern for the new government in terms of policy co-ordination in containing inflation.

The New Keynesian macroeconomics was transformed into what we now label as New Consensus Macroeconomics (NCM) (Arestis, 2009). The major policy implications of the NCM paradigm are particularly important for inflation containment. The NCM pitches that price stability can be achieved through monetary policy since inflation is a monetary phenomenon; as such it can only be controlled through changes in the rate of interest. It is, thus, agreed that monetary policy is effective as a means of inflation control (Arestis, 2009). This is controversial in the context of developing countries like India, as inflation is not strictly monetary process. The conceptual framework of inflation targeting in the context of India raises concern, even more after Finance Minister endorsing to having a "new monetary framework".

III. **Revival of Economic Growth**

The fall in economic growth is attributed to global economic slowdown. Also, Government of India remained complacent about the fact that even after a decline; average growth was higher than the emerging market economies. The alternative arguments put forward by many others attributed this decline to the "policy paralysis". Union Budget 2014 has taken some measures related to revival of growth which includes boost to infrastructure projects, a relook into mining regulations, a step forward to GST reforms and FDI in core sectors. The financial sector reforms and the steps towards financial inclusion also indicate a reinforcement of real and financial sector towards the revival of economic growth.

IV. Institutions and Size of Government

In recent years, institutions have become the central focus of economists studying the processes of growth and why nations have differed so greatly in their economic development goals (Nelson, 2008, Acemoglu and Robinson, 2012). What are institutions exactly? North (1991) defines "institutions are the rules of the game in a society or, more formally, are the humanly devised constraints that shape human interaction." The big focus of the new government is on 'less government' and maximum governance. The governance may also be market-oriented. The appointment of Expenditure Reforms Commission, announced in the Union budget, is bold and welcome. However, the expenditure is concentrated in a few Departments of Government of India. As per the Union Budget 2014, around eight per cent of public expenditure is concentrated in 10 Departments (Table 2).

Table 2 : Expenditure Budget across Departments

GRAND TOTAL	1794892	
MINISTRY OF FINANCE	640404.2	35.68
MINISTRY OF DEFENCE	285202.9	15.89
MINISTRY OF CONSUMER AFFAIRS, FOOD AND I	115952.6	6.46
MINISTRY OF RURAL DEVELOPMENT	83852.46	4.67
MINISTRY OF HUMAN RESOURCE DEVELOPMENT	82771.1	4.61
MINISTRY OF CHEMICALS AND FERTILISERS	73618.55	4.10
MINISTRY OF HOME AFFAIRS	65745.28	3.66
MINISTRY OF PETROLEUM AND NATURAL GAS	63543	3.54
MINISTRY OF HEALTH AND FAMILY WELFARE	39237.82	2.19
MINISTRY OF ROAD TRANSPORT AND HIGHWAY	34345.2	1.91

Source: Government of India (2014) : Union Budget 2014 documents.

I. Conclusion

The economic growth plummeted. Identifying the plausible policy priorities for growth revival is the single most significant agenda before the new government. What wasthe policy priorities highlighted in Union Budget 2014? There is simultaneously continuity and a change. The change relates to the new macroeconomic consensus to undertake inflation management. The Finance Minister has endorsed the need for a "new monetary framework" in his budget speech. This announcement by Finance Minister needs to be co-read with the Urjit Patel recommendations for Central bank independence, and rules-based monetary policy. The shift of macroeconomic policies from discretion to rules – both in fiscal and monetary policy – a new consensus gaining momentum in India. Union Budget has set a broad path to address the issues related to "Policy paralysis", which includes infrastructure investment, tax reforms, controlling bad subsidies and governance reforms. Though the revival of fiscal dominance is widely acknowledged, has a new discourse towards inflation targeting and central bank independence begun a new consensus in India, aftermath to Union Budget 2014?

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