The 2014-15 Indian Budget and Beyond

Arvind Subramanian
PIIE-Government of India-USIBC Event
Washington DC
March 9, 2015
Overview

• Context
  – Expectations
  – The Fourteenth Finance Commission

• Content
  – The public investment push
  – The commitment to fiscal discipline

• Risks
  – External environment
  – Implementation challenges

• Assessment
  – The meaningful package?
Big Bang Reforms and India’s Sweet Spot?

- Post-war cross country evidence suggests that Big Bang reforms occur during or in the aftermath of a major crisis

- Big Bang reforms in robust democracies with multiple actors & institutions with the power to do, undo & block are exceptions rather than rule

- A moment that comes “but rarely in history”

- Political mandate plus benign external environment = Possibility of achieving sustainable double-digit growth

- With a bold policy shift in areas under government control, plus “a persistent, encompassing, and creative incrementalism” in other areas can cumulate to a Bang
The Fourteenth Finance Commission: Watershed for Federalism and Public Finances

### Transfers: Tax, Non-Plan and Plan (as % of divisible pool)

<table>
<thead>
<tr>
<th></th>
<th>Average (last 3 years)</th>
<th>2014-15 RE</th>
<th>2015-16 BE</th>
</tr>
</thead>
<tbody>
<tr>
<td>States share from FC</td>
<td>37.3</td>
<td>37.9</td>
<td>49.3</td>
</tr>
<tr>
<td>Tax Devolution</td>
<td>32</td>
<td>32</td>
<td>42</td>
</tr>
<tr>
<td>Non-Plan grants</td>
<td>5.6</td>
<td>6.1</td>
<td>7.2</td>
</tr>
<tr>
<td>FC transfers + CAS (Plan transfers)</td>
<td>63.9</td>
<td>62.3</td>
<td>64.0</td>
</tr>
</tbody>
</table>

### States' Share in National Taxes (%)

- **2014-15 RE**: 50
- **2015-16 BE**: 52

- **2014-15 RE**: 54
- **2015-16 BE**: 58

- **2014-15 RE**: 56
- **2015-16 BE**: 60

- **2014-15 RE**: 58
- **2015-16 BE**: 62

- **2014-15 RE**: 60
- **2015-16 BE**: 64
The Investment Challenge: Balance Sheet Syndrome with Indian Characteristics Holds Back Private Investment
Fiscal Consolidation Continues, Quality Improves

Recent Fiscal History, 2002-03 to 2014-15 (Percent of GDP)

- Growth drives fiscal improvement
- Loss of fiscal control due to counter-cyclical tax policy and high expenditures
- Gradual stabilization

- Total outstanding liabilities (RHS)
- Fiscal deficit
- Revenue expenditure
- Non-defence capital
Growth Forecast: 8.1-8.5 % for 2015-16. Balance of evidence shows India is recovering robustly not surging.

Difference between New & Old Estimates of Growth, 2012-13 and 2013-14 (%)

- Agriculture & allied
- Industry
- Manufacturing
- Services
- Total

2012-13
2013-14
Difference between New & Old Estimates of Growth, 2012-13 and 2013-14 (%)
Risks

• External
  – Oil
  – Fed and Eurozone
  – Trade challenge

• Domestic
  – Implementation, implementation, implementation
The Trade Challenge: Stagnating Exports, Deteriorating External Trade Environment

Exports of Manufactured Goods & Services (% GDP)

- Services exports as a proportion of GDP
- Manufacturing exports as a proportion of GDP

Export Buoyancy of Indian Exports Relative to Foreign Growth

- Ratio of service export growth to World GDP growth
- Ratio of mfg export growth to World GDP growth
Assessment

• Reforms continue and momentum accelerated

• Package:
  – Macro-economic stability
  – Investment-focused budget plus fiscal discipline
  – Monetary easing
  – Unleashing “cooperative and competitive federalism”
  – GST, FDI in insurance, transparent coal auctions, new land laws, and progress in direct benefit transfers