Education, Agriculture and Subsidies: Long on Words

The opportunity provided by high growth and a comfortable revenue situation to make a serious attempt to boost allocations for education and agriculture has been allowed to slip away. The high priority status accorded to these sectors in the budget speech is not backed by numbers. Instead the numbers have been played around with – such gimmickry only serves to make budgets lose their credibility. Further, the track record of the government fails to inspire confidence that the fiscal targets will be attained. One cannot help but conclude that Budget 2007-08 appears to be long on words alone.

MALA LALVANI

With the economy having embarked on a higher growth trajectory and with revenue situation being comfortable, a resource crunch ceased to be the Achilles heel for Budget 2007. Consequently, this budget called for a shift of focus from additional resource mobilisation to allocation of resources. A scrutiny of the budget numbers shows that the opportunity provided by high growth to make a serious dent in the current low level allocation for social sectors and agriculture, the priority sectors, correctly identified by the finance minister, has been missed – a costly miss, we daresay.

One can have no dispute with finance minister P Chidambaram when he says that implementation of the programmes is crucial. Undoubtedly, the finance minister and his budget have but a limited role of only providing the resources and from there on how the resources get utilised/misutilised is something that we can hardly blame or give credit to the finance minister himself. Having said this, the least that we can, and do, expect from any budget are honest and transparent statements backed by allocations. By not doing so, and by playing around with numbers instead, budgets have, over time, tended to lose their credibility. Budget 2007 was no exception.

The budget sends out the right signals of curbing deficits and pruning revenue expenditure. However, a scrutiny of the track record of the incumbent government, as attempted in this article, fails to instil in us the confidence that the mandate of the Fiscal Responsibility and Budget Management (FRBM) Act will be adhered to.

Another important reason why, to us, the deficit target appears suspect is subsidies. The article delves a little deeper into the issues confronting petroleum and fertiliser sectors. We begin with the big picture and provide details and numbers to substantiate the issues that have been flagged above.

I
The Big Picture

(a) *Assets and liabilities:* The Statement of Assets and Liabilities of the central government gives details of the stock of debt – internal, external and other liabilities – of the government. A positive value of "Excess of Liabilities over Capital Outlay and Loans Advanced" is indicative of debts raised but not spent on creating capital assets. It is important to carefully define this "excess" as liabilities are cumulative. The "excess" reflects the amount of debt that has been accumulated to fund previous revenue deficits. Table 1 provides the values of this excess over the last few years.[1]

Table 1 shows that the government hopes to bring down the share of this "excess" of liabilities to capital outlay from over 29 per cent of GDP in the first two years of its tenure to 28.7 per cent in the revised estimates (RE) of 2006-07 and further to 26.9 per cent in budget estimates (BE) of 2007-08. In other words, the figures signal that lesser proportion of borrowing would go towards revenue expenditures. The signal is right but is there any clear indication of revenue expenditures being pruned? A clearer picture on whether this target appears feasible would emerge when we closely inspect the expenditure side of the budget in the following sub-section.

(b) *Expenditures***:** Table 2 shows that the share of revenue expenditure in total expenditures has risen from 77 per cent in the first year of the UPA regime to 87 per cent in the two subsequent years. The budget for 2007-08 hopes to prune this share to 82 per cent. Conversely, the share of capital expenditure in total expenditure shows a downward trend from 23 per cent in 2004-05 to 18 per cent in 2006-07(RE), i e, a reduction of 5 percentage points.

As a share of GDP, revenue expenditure seems to remain more or less constant at around 12 per cent with marginal changes across years. The share of capital expenditures in GDP has in fact declined by one percentage point.

Thus, key macro indicators show that the UPA government's performance has not been any different from its predecessors. They have not been able to take the

Table 1: Excess of Liabilities over Capital Outlay

	2004-05	2005-06	2006-07(RE)	2007-08(BE)
Excess of liabilities over capital outlay (Rs crore)	910699.82	1065399.1	1174759.5	1246737.3
Excess of liabilities over capital outlay (as per cent of GDP)	29.18	29.87	28.65	26.91

Source: Receipts Budget, 2007-08.

Table 2: Key Macro Indicators
(In per cent)

	2004-05	2005-06	2006-07(RE)	2007-08(BE)
Revenue expenditure/total expenditure	77.14	86.89	87.13	81.98
Capital expenditure/total expenditure	22.86	13.11	12.87	18.02
Revenue expenditure/GDP	12.31	12.33	12.36	12.04
Capital expenditure/GDP	3.65	1.86	1.83	2.65

Source: Expenditure Budget, Vol I.

politically difficult decisions to curb revenue expenditures and raise capital expenditures. The compulsions of a coalition form of government have become the common pretext for justifying failures on this front. However, Echiverri-Gent (1998) and Lalvani (2005) have shown that the coalitions have not necessarily been a hindrance in taking politically hard decisions.

Table 3 reviews the track record of the government by juxtaposing the budget estimates, revised estimates and actuals over the three years of the UPA tenure. It shows that: (i) The performance of the UPA was good in the first year of its term where it succeeded in keeping the share of revenue expenditure below its budgeted share. (ii) In the second year 2005-06 the government marginally exceeded the targeted share of revenue expenditure and fell a little short on the capital expenditure front by 0.08 percentage point. (iii) In the third year 2006-07 the revised estimates (RE) of revenue expenditures in total expenditures has exceeded the budgeted amount and capital expenditure fallen short of the budget estimates (BE) by 0.6 percentage points.

Clearly the government has not been able to maintain fiscal discipline. It has progressively slipped and indulged in greater spending on the revenue expenditure front. Budget 2007 targets a lower share of revenue expenditure than the previous two years. However, the track record does not give us the confidence that this target will be attained.

I
Expenditure Budget

The finance minister announced many hikes on specific programmes of the social sector and agriculture. However, with the total size of the budget itself having grown, a high priority status could be said to have been accorded if and only we see a hike in the share of that sector in the total expenditure. We took a close look at the share of total expenditure allocated to social services (specifically education) and agriculture and allied activities – the two priority sectors identified by the government in Budget 2007.

Social services: Education: Table 4 reveals that the share of social services in total expenditure has gradually risen over the UPA regime (much too gradual as the numbers indicate). However, after hearing the speech of the finance minister and anticipating the "Big Push", one can't help but feel disappointed when one looks at the share of social sectors in total expenditure. As compared to the RE of 2006-07, the BE of 2007-08 budgets for a hike of merely 0.7 percentage points in the share of social services on the revenue account and a hike of 0.9 percentage points in the share of social services on the capital account.

The disappointment escalates when we look at expenditure on education (for which a separate education cess was already in place and which has now an additional 1 per cent for secondary and higher education). Table 4 shows that the share of general education (on revenue account) in total expenditure is in fact lower at 3.09 per cent vis-à-vis the RE of 2006-07 (3.23 per cent). The share of technical education, however, is budgeted to rise from 0.29 per cent to 0.57 per cent. We will comment on this when we look at the track record of the government in this area.

On the capital expenditure side, the status quo is being maintained in the case of education with the same share of 0.01 per cent that the UPA government has set aside since the beginning of its term in 2004-05. One cannot help but ask where the big thrust is to education that the finance minister so often repeated in his budget speech.

In addition to making statements that are the not backed by numbers, the finance minister has played around with numbers when he announced that the allocation to school education had been hiked by 35 per cent. A hike computed without any adjustment here would be erroneous as the responsibility of the department of schools has undergone a change. The numbers for 2006-07 (RE) exclude secondary education (included in the department of higher education). In 2007-08(BE), however, secondary education is included in the department of school education. To compute the actual hike in allocation to schools and secondary education we made the definition of the two departments comparable over the two years by conforming to the current definition of including secondary education in the department of schools. This revealed that the hike for the purpose of elementary and secondary education combined works out to 21.4 per cent and not 35 per cent. Such gimmickry puts the credibility of the budget at stake.

Yet another important fact to take note of is the revenue from the education cess. In RE of 2006-07, the education cess funded 38 per cent of total spending on education, i e, 62 per cent was provided by the government from other sources. In BE of 2007-08 the education cess will be funding 49 per cent of the total spending on education. Thus implying that the other budgetary sources would fund only 51 per cent of the educational spending. The above figures suggest that the education cess is being used as a substitute to allocations from the general budget and not as an additional/supplementary revenue source to bolster the existing allocation to education.

The track record of the incumbent government as regards expenditure on social

Table 4: Expenditure on Social Services and Education
(As per cent of Total Expenditure)

	2004-05	2005-06	2006-07(RE)	2007-08(BE)
Social services (on revenue account)	6.21	7.32	7.46	7.53
(i) General education	2.38	2.77	3.26	3.11
(ii) Technical education	0.29	0.30	0.29	0.57
Social services (on capital account)	0.19	0.16	0.18	0.27
(i) Education, sports, art and culture	0.01	0.01	0.01	0.01

Source: Annual Financial Statement and Expenditure Budget, Vol I, various issues.

Table 3: Some Key Ratios
(In per cent)

	2004-05 (BE)	2004-05 (RE)	2004-05 (Actual)	2005-06 (BE)	2005-06 (RE)	2005-06 (Actual)	2006-07 (BE)	2006-07 (RE)	2007-08 (BE)
Revenue expenditure/total expenditure	80.68	76.33	77.14	86.81	86.55	86.89	86.56	87.13	81.98
Capital expenditure/total expenditure	19.32	23.67	22.86	13.19	13.45	13.11	13.44	12.87	18.02

Source: Expenditure Budget, Vol I, various issues.

services would become clear from Table 5. It shows while the performance was good in the first two years, in 2006-07(RE), the share of general education is seen to be lower than the BE of that year. In the discussion previously we pointed out that the share allocated to general education was lower than the 2006-07(RE). What Table 5 now reveals is that the share of education in total expenditure in 2007-08 (BE) is in fact also lower than 2006-07(BE). To say that we were surprised at this revelation would be putting it very mildly.

As regards technical education, it is observed that the share of expenditure actually incurred has consistently been lower than the budgeted amount. This clearly suggests that absorptive capacity here is missing. The focus here must be not only on enhancing allocations as has been done in Budget 2007 but to see to it that this amount gets utilised.

We now turn to a similar analysis for economic services, specifically agriculture, rural development, irrigation and flood control.

Economic services: Despite the strong emphasis on agriculture, Table 6 shows that the share of expenditure budgeted for agriculture and allied activities in 2007-08 (7.09 per cent) is seen to be lower than the RE of 2006-07 (7.84 per cent). A similar pattern of the share in 2007-08(BE) being lower than the 2006-07(RE) is discerned for rural development, irrigation and flood control and transport. Once again the track record of the government is evident from Table 7.

It is disconcerting to note that the share of total expenditure set aside for agriculture and allied activities is merely 0.01 percentage points higher than in 2006-07 (BE) and significantly lower than the budget estimates of 2004-05 and 2005-06. Once again the pride of place accorded to agriculture in the budget speech seems to be missing in the budgetary allocations. An identical pattern is observed for rural development, irrigation and flood control and transport.

In the section that follows we probe deeper into the problem of rising subsidies.

III
Lull before the Storm?

Subsidies have always been a nightmare for every finance minister. Any explicit attempt to prune subsidies results in an inevitable outcry. We discuss some of the issues involved in petroleum and fertiliser subsidies.

Petroleum subsidy: Oil pool account to oil bonds: The contribution of the petroleum sector to the central and state exchequer can hardly be over-emphasised. Almost 40 per cent of the excise collections and about 25 per cent of customs collection come from the oil sector. A recent study by International Energy Agency (2006) draws attention to the excessive tax burden on petroleum companies. In addition to custom and excise duties, the oil sector bears two additional levies (cess imposed by the Oil Industry Development Board and education cess) and a central sales tax. As if this was not enough, the state governments are also authorised to levy certain taxes and surcharges on petroleum products – value added tax (VAT) and/or sales tax, entry tax, transit charges and other levies. Also, within the states, local government units can levy extra charges on petroleum products. Mumbai for example levies an extra 1 per cent on VAT.

Till as recently as 2002 the petroleum sector had to shoulder a heavy tax burden on the one hand and deal with the administered price mechanism (APM) on the other. The subsidy provided on petroleum products came out of the Oil Pool Account, funded by surcharges on petroleum products. The Oil Pool Account thus allowed the government to keep these liabilities off-budget.

In 2003-04, the government realised that the financial burden on the Oil Marketing Companies (OMCs) was critical and since an increase in retail prices were not politically feasible, profit making upstream oil companies were asked to share the burden of under-recovery. When their problems escalated, a formula was put into place and OMCs could increase prices on the basis of a rolling average of cif price for the last three months within a 10 per cent band. When international prices continued to climb, the formula was quietly abandoned as the OMCs were always requested by the government to keep prices constant for social (and political) reasons. This resulted in mounting losses and "under-recoveries" in this sector: 2004-05: Rs 20,146 crore, 2005-06: Rs 40,000 crore and 2006-07 (April-December): Rs 41,248 crore (Prov) [Petroleum Planning and Analysis Cell].

The government found an ad hoc solution to the problem in "oil bonds" – they provided relief to the ailing OMCs but added to the government liabilities, once again off-budget. The Rangarajan Committee (2006) was forthright in stating that oil bonds simply meant postponing the

Table 6: Expenditure on Economic Services
(As per cent of Total Expenditure)

	2004-05	2005-06	2006-07(RE)	2007-08(BE)
Economic services (on revenue account)	30.842	36.729	41.772	32.820
(i) Agriculture and allied activities	7.64	7.40	7.84	7.09
(ii) Rural development	1.99	3.09	5.45	2.44
(iii) Irrigation and flood control	0.09	0.08	0.07	0.06
(iv) Transport	12.12	13.68	14.42	13.58
Economic services on capital account	3.91	3.96	4.47	9.36
(i) Agriculture and allied activities	0.02	0.01	0.01	0.01
(ii) Rural development	0.00	0.00	0.00	0.00
(iii) Irrigation and flood control	0.00	0.00	0.00	0.00
(iv) Transport	2.46	2.66	2.06	1.76

Source: *Annual Financial Statements,* various issues.

Table 5: Track Record of Expenditure on Social Services and Education
(As per cent of Total Expenditure)

	2004-05 (BE)	2004-05 (RE)	2004-05 (Actual)	2005-06 (BE)	2005-06 (RE)	2005-06 (Actual)	2006-07 (BE)	2006-07 (RE)	2007-08 (BE)
Social services (on revenue account)	5.34	5.70	6.21	6.48	7.10	7.32	7.39	7.46	7.53
(i) General education	1.87	2.10	2.38	2.55	2.62	2.74	3.31	3.23	3.09
(ii) Technical education	0.32	0.28	0.29	0.31	0.27	0.30	0.30	0.29	0.57
Social services (on capital account)	0.24	0.78	0.19	0.15	0.78	0.19	0.21	0.78	0.19
(i) Education, sports, art and culture	0.01	0.04	0.01	0.01	0.04	0.01	0.01	0.04	0.01

Source: *Annual Financial Statements and Expenditure Budget,* various issues.

problem and strongly advised against it.

Undoubtedly the budget is not the only place where major decisions pertaining to the petroleum sector can be addressed. However, there was one simple recommendation of the Rangarajan Committee which could have been easily addressed in the budget, viz, restructuring of the excise duty structure from the present mix of specific and ad valorem to a purely specific levy. It was argued that ad valorem levies exacerbate the burden on the consumer and also result in the government benefiting through higher tax yields. Budget 2007 has chosen to ignore this recommendation and merely reduced the ad valorem rate from 8 per cent to 6 per cent. While this will provide some immediate relief to the OMCs if the reduction is not passed on to the consumer, this reduction fails to solve the structural problem that the Rangarajan Committee report was addressing.

Recently the ministry of petroleum has asked for an extension of the subsidy on kerosene and LPG (to expire in April 2007) to 2010 and has asked that the entire subsidy be met from the budget. An ORF Policy Brief (February 2007) pointed out that if this was to happen then budget would need to keep aside Rs 28,600 crore as petroleum subsidy. The finance minister has chosen to keep aside only Rs 2,840 crore. The solution of oil bonds would lead to off-budget liabilities and mere postponement of the crisis while the hike in subsidies will jeopardise the FRBM target. The only way out of this maze is to take tough decisions of reducing the tax burden on OMCs so as to lower production costs and unleash market forces. Policies which have been kept alive "in the name of the poor" will have to be abandoned and equity concerns will need to be addressed differently.

Fertiliser subsidy: It is by now well accepted that "these subsidies are larger than necessary as domestic manufacturers of urea are given a cost plus price under the Retention Price Scheme (RPS). This provides very little incentive to domestic manufacturers to cut costs" [Expenditure Reforms Commission 2000]. However, these subsidies are also the most politically sensitive of the lot of subsidies. Former finance minister Yashwant Sinha earned himself the reputation of "roll back minister" as all his attempts to prune this subsidy had to be reverted. Among fertilisers, urea continues to be one sector that is still regulated. The RPS has been in operation since 1977-78. The scheme has come in for sharp criticism on account of the fact that it encouraged inflating (more popularly known as gold plating) of capital costs by fertiliser plants.

One aspect that has been often discussed in literature is the share of the subsidy that goes to the farmer vis-à-vis that which goes to the industry. The share of the farmer could be computed as the difference between import parity price that would have prevailed under free trade and the domestic prices [Gulati 1990]. As the gap between the two increases, the subsidy share of the farmer increases. It is true that in recent years the cif price of urea has increased significantly and so has the subsidy share of the farmer. Table 8 computes the average share of the farmer in the fertiliser subsidy for the period 2000-01 to 2005-06 and compares it with the share in the 1990s in Gulati and Narayanan (2003).

Table 8 shows that the share of the farmer has risen from 53 per cent in the 1990s to 88 per cent in the period 2000-01 to 2005-06. However, these numbers alone tell only part of the story and cannot be used to justify the persistence of fertiliser subsidy. Gulati and Narayanan (2003) carry out an in-depth analysis of urea plants and draw attention to the inefficiency prevalent urea industry. Based on their resource cost estimates of urea plants they observe that unless costs of production were reduced, 32 per cent of urea production would become economically unviable if import parity price were to prevail.[2] The findings of their study lead them to conclude that with the dismantling of the administered price mechanism in the petroleum sector and removal of concession on feedstock (i e, naptha and furnace oil/low suphur heavy stock), the subsidy bill would mount unless farmgate prices were raised or capital costs cut.

Conforming to expectations, the fertiliser subsidy for 2006-07(RE) exceeded the budgeted amount by Rs 5,199 crore. The explanation provided for this is the rising cost of naptha. According to the industry, the amount provided falls short of requirement thus necessitating a carry forward of almost Rs 12,000 crore into the financial year 2007-08. This would naturally mean that the budgeted fertiliser subsidy at

Table 8: Fertiliser Subsidy

	1990-91 to 1999-2000	2000-01 to 2005-06
Average cif price of urea (Rs/tonne)	4712.18	8844.41
Average domestic price of urea (Rs/tonne)	2908.60	4831.67
Average subsidy to farmer (Rs/tonne) (Gulati method)	2720.98	4012.74
Average consumption (000 tonnes)	17313.40	20054.50
Total subsidy to farmer (Rs crore)	4710.94	8047.35
Average budget subsidy (crore)	8846.6	9089.33
Farmer's share of the subsidy (per cent)	53.25	88.54

Source: The data for 1990s is based on Gulati and Narayanan (2003) and computation for 2000-2006 from data in fertiliser statistics, 2005-06.

Table 7: Track Record of Expenditure on Economic Services

(As per cent of Total Expenditure)

	2004-05 (BE)	2004-05 (RE)	2004-05 (Actual)	2005-06 (BE)	2005-06 (RE)	2005-06 (Actual)	2006-07 (BE)	2006-07 (RE)	2007-08 (BE)
Economic services on revenue account	31.10	30.11	30.84	32.993	37.661	36.73	34.482	41.77	32.82
(i) Agriculture and allied activities	7.58	7.18	7.64	7.64	7.22	7.40	7.08	7.84	7.09
(ii) Rural development	1.45	1.69	1.99	2.21	2.77	3.09	2.75	5.45	2.44
(iii) Irrigation and flood control	0.07	0.06	0.09	0.08	0.07	0.08	0.08	0.07	0.06
(iv) Transport	11.62	11.36	12.12	12.82	13.56	13.68	13.93	14.42	13.58
Economic services on capital account	4.83	3.96	3.91	4.61	4.14	3.96	4.29	4.47	9.36
(i) Agriculture and allied activities	0.02	0.04	0.02	0.07	0.12	0.01	0.03	0.01	0.01
(ii) Rural development	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
(iii) Irrigation and flood control	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
(iv) Transport	2.40	2.38	2.46	2.50	2.51	2.66	1.96	2.06	1.76

Source: Annual Financial Statements, various issues.

Rs 2,2451 crore is a grossly underestimated number. Can fertiliser subsidies prove to be a threat to the FRBM target next year?

Summing Up

High growth and buoyant revenues – all that every finance minister aspires for were there prior to Budget 2007. There could not have been a more opportune time to boost allocations to social sectors and agriculture. The finance minister got the sectors right but allowed the opportunity to slip away by not backing up his promises to these sectors with budgetary allocations.

If one were to size up Budget 2007 from a macro perspective and without getting caught up in the maze of details, one would say that very little has changed from the previous year as far allocations to education and agriculture are concerned. The shares allocated to the so-called "priority sectors" of education and agriculture seem to very nearly maintain the status quo. Budget allocations do not reflect what the budget speech promised to these sectors.

The macro signals of pruning deficits and revenue expenditures are correct but the track record of the government fails to inspire in us that these targets will indeed be met. A potential threat to the FRBM target stems from subsidies. The escalating problems of petroleum and fertiliser industry clearly signal an impending storm – some hard decisions in this context need to be taken head on if we are to escape getting caught in the eye of the storm. EPW

Email: mala.lalvani@gmail.com

Notes

[Sincere thanks to Abhay Pethe and Ajit Karnik for their comments and invaluable suggestions, that too at very short notice. Special thanks to Ashok Gulati for patiently answering my queries and introducing me to the nitty-gritty of the fertiliser industry. Needless to say, any errors that may remain are solely my responsibility.]

1 It is important to note that the ratios to GDP are only computed to normalise and do not indicate the proportion of debt that is being funded out of the current year GDP.

2 An update of these figures for more recent years would be interesting but not easily obtained as firm wise disaggregated data on costs and retention prices are not available anywhere on public domain.

References

Echiverri-Gent (1998): 'Weak State, Strong Reforms? Globalisation, Partisan Competition and the Paradox of India's Economic Reform', paper presented at the 1998 Annual Meeting of the American Political Science Association, Boston MA, September 3-6.

Expenditure Reforms Commission (2000): 'Rationalising Fertiliser Subsidies', http://expenditurereforms.nic.in/fersub.pdf (viewed March 28, 2007).

Gulati, A (1990): 'Fertiliser Subsidy: Is the Cultivator 'Net Subsidised'?', *Indian Journal of Agricultural Economics,* Vol 45(1), January-March.

Gulati, A and S Narayanan (2003): *The Subsidy Syndrome in Indian Agriculture*, OUP.

International Energy Agency (2006): 'Petroleum Product Pricing: Where Have the Subsidies Gone?'.

Lalvani, M (2005): 'Coalition Governments: Fiscal Implication for the Indian Economy', *American Review of Political Economy*, Vol 3(1).

ORF Policy Brief (2007): 'What Do Falling Crude Prices Mean for India's Fiscal Deficit?'.

Petroleum Planning and Analysis Cell, http://ppac.org.in/OPM/uromcs_feb.pdf http://ppac.org.in/oil_prices_taxes.htm.

Rangarajan Committee Report (2006): 'Report of the Committee on Pricing and Taxation of Petroleum Products' (under chairmanship of C Rangarajan).