The New York Times

February 27, 2013

Big Decisions for India Amid Slowing Economy

By JIM YARDLEY

NEW DELHI — Not too long ago, when India's economy was roaring amid predictions of high growth rates for years to come, the finance minister could be forgiven for strutting during budget week. He got to march into India's Parliament with the ceremonial briefcase bearing a budget stuffed with goodies.

But on Thursday, when the current finance minister, Palaniappan Chidambaram, arrives in Parliament, his steps will be heavier, and the mood is likely to be, too. Faced with slowing growth, persistent inflation and sagging investor confidence, India's government is pinned between conflicting pressures: economists warn that tough steps are needed to avoid long-term fiscal problems, even as political leaders are leery of introducing unpopular measures before important elections this year.

On Wednesday, the government sought to change the pessimistic narrative, as the Finance Ministry released its annual economic survey and projected that economic growth would jump somewhere above 6 percent during the next fiscal year, predicting that the downturn was "more or less over and the economy is looking up." Some economists were skeptical, given that similar rosy predictions in recent budgets have proved wrong.

"Let me remind you that last year the economic survey spoke of about 7.6 percent projected growth — and what we had was 5 percent growth," said Ajay Bodke, head of investment strategy and advisory at Prabhudas Lilladher, a Mumbai brokerage. "That is not just a miss but a humongous miss."

The consequences of the budget plans are especially high because India, once a darling of global investors and an anointed power-in-waiting, is struggling to regain its lost luster.

India's estimated 5 percent growth rate for the current fiscal year compares with 8 percent in 2010. Ratings agencies have threatened to downgrade the country's investment rating to "junk" status. Meanwhile, India's political class has spent more than three years enmeshed in scandals, as a bickering Parliament has accomplished almost nothing.

“It’s a supercritical moment, actually,” said Rajiv Kumar, an economist with the Center for Policy Research in New Delhi. “If you get it right, and this is a budget that can shore up the government’s credibility, they can turn it around.”

For investors and business leaders, the question is whether the government will make tough calls to address the country’s large fiscal and account deficits, curb huge subsidies for diesel fuel and petroleum products, unclog bureaucratic bottlenecks on stalled manufacturing, energy and infrastructure projects and create incentives to entice new investment.

Only a year ago, Pranab Mukherjee, then finance minister, unveiled a budget now regarded by many analysts as a major mistake. Desperate to increase revenues, the government spooked investors by giving broad latitude for tax collectors to pursue multinationals for billions of dollars in new, unexpected taxes. Investment slowed markedly, while investors and political opponents complained that India’s coalition government, led by the Indian National Congress Party, was endangering one of the world’s fastest-growing economies.

“The economy is in a deep crisis at the moment,” said Yashwant Sinha of the opposition Bharatiya Janata Party, a former finance minister, “and I only hope the crisis doesn’t become any deeper with more pre-election sops.”

Mr. Sinha and many independent economists warn that the economy cannot afford a repeat of 2008, when the government was preparing for national elections the following year. Then, the pre-election budget was filled with big spending measures, including pay raises for government workers and the forgiveness of billions of dollars in loans to farmers. The government was easily re-elected in 2009, but the new spending contributed to a fiscal deficit that rose to roughly 6 percent, from about 2 percent the previous year.

Now, the Congress Party is preparing for state elections this year, while positioning itself for the national races in 2014, when Parliament and control of the government will be up for grabs. Some economists argue that a tough budget this week could restore confidence and jump-start economic growth by the end of this year, providing the government with a political lift in 2014. Yet there is also speculation in political circles that the Congress Party may call early elections, as soon as this year, and would want to curry votes with a budget laced with more spending.

Meanwhile, many social advocates cite the gross inequality in Indian society — which has hundreds of millions of people still living on $2 a day or less — and are pushing to expand the safety net. In particular, Congress Party leaders have endorsed plans for the National Food Security Bill, which would expand the number of people eligible for government food subsidies at a huge cost.

Many analysts say the government must clearly show how the measure would be financed, or risk even deeper damage to the country’s fiscal situation.

“This year’s budget will be especially important for convincing investors that India’s fiscal position is back on a sustainable track and that populist policies won’t overwhelm the pressing need to bring down the fiscal deficit and put public debt on a downward trajectory,” Eswar Prasad, an economist at Cornell University and an adviser to India’s finance minister, said via e-mail.

Prime Minister Manmohan Singh, considered a father of the 1990s market reforms that prompted the country’s two-decade economic boom, recently warned of “formidable challenges” facing the country. Mr. Chidambaram, the finance minister, who is known as a tough-minded political troubleshooter, has instituted a five-year plan to trim the deficit and was credited with pushing through measures last year that reduced fuel subsidies and opened the retail and aviation sectors to more foreign direct investment.

But if these steps buoyed the spirits of the business community, they have not yet revived economic growth. In Wednesday’s report, the Finance Ministry predicted that growth rates would improve to between 6.1 percent and 6.7 percent in the next fiscal year. Many independent economists are far less optimistic, projecting growth between 5 percent and 5.5 percent.

Neha Thirani Bagri contributed reporting from Mumbai, India.