Institute for Strategic and Socio-Economic Research

Pavilion Group

CONTEMPORARY ISSUES

NO. 1, 2019

Indian Budget 2019
General Overview and Its impact on Nepalese Economy

Dr. Ravindra Prasad Pandey, Satyendra Timilsina, Archana Neupane

Highlight

- Indian Finance Minister presented INR 27.9 trillion budget for FY 2019-20.
- Size of the Indian government is only 32.7 larger than the size of the Nepalese government.
- If managed properly then Nepal can take benefit of higher economic growth of India.
- Volume of most of the export items from Nepal to India may not increase significantly next year.
- Exports items like Marble slabs, Chemicals, Garments, Thread may get affected adversely.
- It is quite possible that Indian export to Nepal may increase next year.
- Upsurge of gold-import-duty in India, it is more likely that the informal gold-trade in Nepal would further increase.
- Petroleum price in Nepal may increase. This will have effect on general price level.

General Overview

With a vision to become a 5 trillion-dollar economy driven by investment, Indian Finance Minister Nirmala Sitharaman presented INR 27.9 trillion budget for FY 2019-20 in the Indian parliament on July 5, 2019. The budget plans to spend 87.8 percent on recurrent expenditure and 12.2 percent on capital expenditure. The planned expenditure is 14.1 percent higher than the budgeted expenditure and 13.4 percent higher than the revised expenditure for FY 2018-19.

On the sources of financing, the Indian Finance Minister has proposed to raise INR 19.6 trillion from revenue sources, INR 1.2 trillion from capital receipts and INR 7.0 trillion from debt financing. While the planned revenue is 70.4 percent of the total budget, capital receipt and fiscal deficit remains at 4.3 percent and 25.3 percent of the total budget respectively. Revenue estimates for the upcoming fiscal year is 13.7 percent higher than the revenue estimates for the current fiscal year. The ratio of estimated total expenditure, revenue and fiscal deficit to GDP for the upcoming fiscal is estimated at 13.2 percent, 9.3 percent and 3.3 percent. Such ratio stood at 13.0 percent, 9.2

percent and 3.4 percent for the current fiscal year.

The Indian government expects for a stronger growth in the upcoming fiscal year. According to the macroeconomic framework statement of the Indian government presented along with the Indian budget, the nominal growth of the economy is expected to be 11.0 percent in the financial year 2019-20. It is in line with the projections for Indian growth by international institutions. The Indian government is expecting to contain inflation within the range of 4 to 4.5 percent, which means the expected economic growth for upcoming fiscal year is 6.5 to 7 percent. "The GDP growth in the short to medium term is expected to hold steady and stabilize at current levels. The nominal gross domestic product is projected to grow at 11.6 per cent and 11.9 per cent respectively in 2020-21 and 2021-22. In real terms, the growth rates for 2020- 21 and 2021-22 work out to 7.3 and 7.5 percent," states the medium-term fiscal policy cum fiscal policy strategy statement of the Indian Government.

Vision for a Decade

The Budget for 2019-20 also sheds vision for the decade. The ten points of the vision are: a) Building physical and social infrastructure; b) Digital India reaching every sector of the economy; c) Pollution free India with green Mother Earth and Blue Skies; d) Make in India with particular emphasis on MSMEs, Start-ups, defense manufacturing, automobiles, electronics, fabs and batteries, and medical devices; e) Water, water management, clean Rivers; f) Blue Economy; g) Space programs, Gaganyan, Chandrayan and Satellite programs; h) Self-sufficiency and export of food-grains, pulses, oilseeds, fruits and vegetables; i) Healthy society – Ayushman Bharat, well-nourished women & children. Safety of citizens; and j) Team India with Jan Bhagidari. Minimum Government Maximum Governance.

Comparing Nepal with India

The size of Indian economy is almost 100 times the Nepalese economy, but the size of the central government's budget does not follow the same trend. The comparative expenditure plans for upcoming budget shows that the size of Indian budget is 32.7 times larger than the Nepalese budget. This indicates that the role of the government in gross value addition in an economy is much lower in India when compared to Nepal. Alternatively, the role of private sector is much stronger in economic growth in India when compared to Nepal. Therefore, the Indian economy is growing at a better rate for the past couple of years despite

Table 1
Comparative Budget: Nepal and India (As percent of GDP)

	Nepal			India		
	2017/18A	**2018/19R**	**2019/20B**	**2017/18A**	**2018/19R**	**2019/20B**
Total Expenditure	36.2	34.8	39.4	12.5	13.0	13.2
Recurrent	26.1	25.8	27.6	11.0	11.4	11.6
Capital	10.1	9.0	11.8	1.5	1.7	1.6
Resources	28.6	26.5	30.0	9.1	9.7	9.9
Revenue	27.2	25.0	28.3	8.4	9.2	9.3
Capital Receipts	1.5	1.5	1.7	0.7	0.5	0.6
Deficit/surplus	7.5	8.3	9.4	3.5	3.4	3.3
Deficit Financing	4.4	7.6	9.4	3.4	3.1	3.1
Net Domestic Borrowings	2.8	6.2	7.9	3.4	3.2	3.1
Net Foreign Borrowings	4.0	4.5	4.5	0.0	0.0	0.0
Net Loan and Investment	-2.4	-3.1	-2.9			
Cash Balance	3.2	0.7	0.0	0.0	0.2	0.2

Source: Budget Speech 2019 for Nepal and India relatively low level of capital expenditure. The capital expenditure to GDP ratio in India is much lower at 1.6 percent as compared to Nepal's 11.8 percent. The comparative budget statistics is presented in Table 1.

The table shows that the size of the budget, revenue mobilization and fiscal deficit with respect to GDP in Nepal are all higher when compared to India. The expenditure to GDP ratio, Revenue to GDP ratio and Fiscal Deficit to GDP ratio for Nepal are almost three times higher than that of India.

Impact of Indian Budget on Nepalese Economy

Countries are interdependent in this era of globalization. Policy changes in one economy trickledown to another through various means. This effect could be stronger for Nepal, mainly because of open border and heavy dependency with India. It has been common that we review Indian policies before formulating similar policies in Nepal to avoid any adverse effect. The recent budget unveiled by the Indian government is likely to affect our economy in number of ways. The impact of Indian budget on Nepalese Economy could be analyzed in three aspects – impact on macroeconomic variables such as economic growth and inflation, impact on trade between the two countries, and impact on other specific sectors.

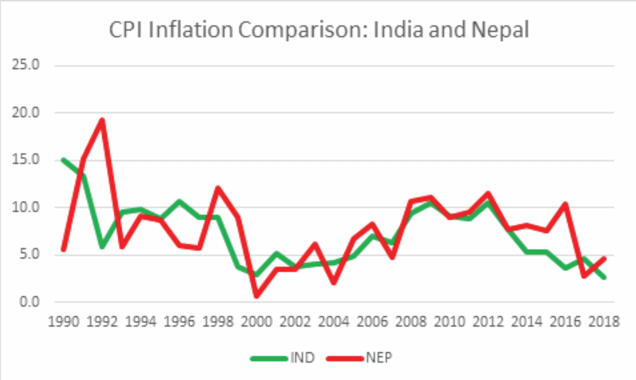
Impact on Macroeconomic Variables

The extent of an effect of one economy on other depends on the level of economic integration between the two economies. And the level of economic integration depends on the level of trade liberalization, financial liberalization and capital account liberalization of the economy. As Nepal has gone for full swing of trade liberalization, controlled financial liberalization and a closed capital account liberalization, the impact of an Indian economy on macroeconomic variables should be analyzed on the same basis.

In terms of an effect of one economy on the economic growth of another, it is said that the growth trickles-down through several modes such as – Foreign Aid, Foreign Trade, Employment and Remittance, Tourism and Foreign Direct Investment. When Indian economy becomes stronger, Nepal too, can expect a trickledown effect through these variables. We need to analyze how has each of these variables changed with the growth of Indian economy to assess if the growth has also been transmitted to Nepal.

Indian assistance to Nepal is continuously on a rise. While the government is the primary recipient of the Indian assistance, the government of India, through its Embassy in Kathmandu, also spends on the development initiatives inside the country. The extent of such spending and its impact on the gross value addition in Nepalese economy is a separate issue of study for Nepal. With rise in per capita income and living standard in India, Nepal could expect an increase in exports to India. But due to productivity issue, which has slowed down the industrialization process, Nepalese exports has not been able to benefit from the Indian growth. Instead, the import from India has increased at much higher rates, widening the trade deficit and exerting stress on the Nepalese external sector. Increasing economic growth in India has created jobs for Nepalese workers. Due to open border and simplified procedure for Nepalese to travel and work in India, good number of people travel to India and work informally. There are thus no records of movement of Nepalese workers in the Indian job market. The number of Indian tourists is on a rise, but their share has been reduced significantly in the last decade. It is the same case with Foreign Direct Investment too. In the last few years, Chinese FDI has surpassed the Indian FDI in Nepal. There is a need to evaluate the impact of these variables in Nepalese GDP to assess the impact of Indian budget and Economic growth on Nepal.

With a control of two third of total trade, India is Nepal's dominant trade partner. Any changes in the prices in Indian market transmits into Nepal through trade and affects Nepalese prices. And this has been substantiated by number of studies which have concluded that Nepalese inflation is significantly affected by price level in India. The following chart shows the path of inflation in India and Nepal. In most of the cases, the inflation in India and Nepal are moving side by side. The correlation between the Indian Inflation and Nepalese inflation after year 2000 is 0.70 indicating higher level of inter-dependence.



Data Source: World Economic Outlook, IMF 2019 April

The government of India has, for couple of years now, promoted Make in India campaign and has adjusted on customs duty to benefit the domestic industry. This year too, the Indian budget has reduced customs duty in inputs and raw materials for cost reduction of domestically produced goods. This would help domestic goods become more competitive than imports. Further, the budget, with an aim to promote domestic industry, has raised customs duty of food processing, chemicals, plastics, rubbers, paper products, textiles, ceramic products, steel products, electronic goods and machines, and automobile and automobile parts.

Impact on Foreign Trade

The government of India has, for couple of years now, promoted Make in India campaign and has adjusted on customs duty to benefit the domestic industry. This year too, the Indian budget has reduced customs duty in inputs and raw materials for cost reduction of domestically produced goods. This would help domestic goods become more competitive than imports. Further, the budget, with an aim to promote domestic industry, has raised customs duty of food processing, chemicals, plastics, rubbers, paper products, textiles, ceramic products, steel products, electronic goods and machines, and automobile and automobile parts.

Nepal's top exportable products to India include cardamom, juice, jute products, Polyester yarn, Zink sheet, wire, rosin, oil cakes, shoes and sandals among others. The export of these products makes almost two third of the Indian export. As this years' Indian budget has not made any changes on the customs duty of these goods, most of the export to India looks to get unaffected. However, the export of items such as Marble slabs, Chemicals, Garments, Thread which are exported in India on a low volume would get adversely affected because of an increase in customs duty of these products. If the export of these products gets affected, we can argue that Nepal could face the heat of protectionism policy in India on the form of 'Make in India'.

There is a risk of increase in the imports from India and increasing trade dependency, mainly due to Indian policy of safeguarding domestic industry by discouraging foreign goods. With reduction in customs duty on inputs and raw materials, discouraging imports by increasing customs duty and other protectionism policies, the Indian production is likely to grow thereby reducing the cost of such products. Any decrease in cost of production in Indian market, will reduce Nepal's export to India, which will ultimately increase the Indian export to Nepal. This could further worsen the trade deficit with India.

The Indian budget has aimed at promoting the use of Electric Vehicles. This could encourage the production of EVs and reduce the costs as well. Nepal could also benefit from it. The Budgetary policy to increase the import duty of gold and jewelry products, and petroleum products could have more effects on informal trade than in formal trade. These issues have been dealt at length below.

Increase in gold import duty and its possible impact

The Indian government has increased the import duty of gold and petroleum products. An analysis on these policies and their likely impact on Nepalese economy is explained below.

The increase in import duty on gold is not a fresh move from the Indian government. The revision on the import duty literally began in 2009-10. For four years in continuation from 2009-10 the Indian government increased the import duty – this however was a specific tax until 2010-11 before introducing an ad valorem tax on gold imports in 2011-12.

Before 2009-10, the import duty on gold bar was at INR 100 per 10-gram, which increased to INR 200 per 10-gram after the Indian Budget for FY 2009-10. The next year, import duty on gold was raised to 300 per 10-gram. In 2011-12 the Indian government introduced an ad valorem tax of 2 percent on gold imports, which was gradually increased until it reached to 10 percent in August 2013. This year the government raised the import duty from 10 percent to 12.5 percent on the import of gold and other precious metals.

Its impact on Nepal

There were no restrictions on the volume of gold-import in Nepal before 2009-10. The control on gold import, which is being practiced since 2010, started after policy changes made through Indian budget in 2009-10. The Indian government's decision to increase import duty of gold-bars in that year's budget, resulted in a huge gold import surge in Nepal. The import data of Nepal Rastra Bank shows that Nepal imported gold worth Rs. 33.6 billion within the first six months of FY 2009-10 as against the import worth Rs 16.8 billion in entire FY 2008-09.

It was evident that the increase in gold import was not to cater the domestic demand but was to gain from taxdifferentials between India and Nepal. This increase in gold-import did not just promote illegal outflow of gold from Nepal, but also hit adversely on the Balance of Payments situation. BOP was negative in that fiscal year.

The government, in recommendation of Nepal Rastra Bank, imposed restriction on gold import in early 2010 to address the issue. After a year, the regulated import of gold was permitted, which allowed banks to import gold equivalent of 15 Kg per-day and distribute to the market in recommendation of Nepal Gold and Silver Dealers' Association and other related associations. This has curbed any possibilities of increasing gold import from a formal channel but has not addressed an issue of gold-smuggling to the third-country. Several evidences show that Nepal has become a transition for gold-smugglers, for some years now.

With the current hike in gold-import-duty in India, it is more likely that the informal gold-trade would further increase. This could pose threat to international relations between Nepal and our neighboring countries and siphon off remittances to informal market. Foreign currency earnings of Nepalese in foreign countries could be used to finance informal gold-trade.

A well-directed move in Nepal could help the country gain from this Indian policy-change. Gems and Jewelry Export Promotion Council in India has stated that the government's move would result in growth of jewelry and diamond business in neighboring countries as foreign tourists will shift to competitive countries. This is where Nepal can benefit.

Petroleum products Price and Its possible impact

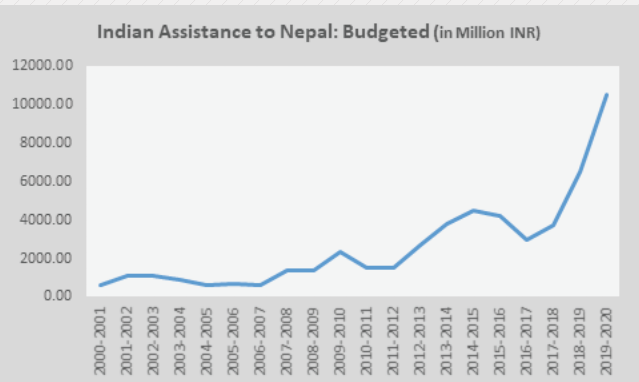
The Indian Government decided to impose additional two rupees per litter of petrol and diesel as special additional excise duty, and road and infrastructure Cess . This increase in tax on petroleum products is expected to increase the price of petrol by more than INR 2.5 per liter and diesel by more than INR 2.3 per liter in the Indian market. As India is currently the sole supplier of petroleum products to Nepal, there can be a debate on how does this affect the price of petroleum products in the country?

Petroleum price in Nepal is mainly governed by the prices charged by Indian Oil Corporation to Nepal Oil Corporation. This price is free of domestic taxes levied on the petroleum products in India. As per the agreement between NOC and IOC, the Indian government has waved both local tax and export duty on petroleum products being provided to Nepal. The IOC, however, charges 2 percent surcharge, which is the cost of supply. This surcharge, known as marketing margin includes costs of equipment, transport, labor, capital, risk and management.

The formal effect of such an increase in internal taxes should not affect the petroleum price in Nepal. However, as the price differential on the petroleum products in bordering cities would increase, there could be a pressure on overall supply of petroleum products inside the country. The outflow of petroleum products to India from Nepal in the bordering cities could rise.

Indian Assistance to Nepal

Nepal is one of the priority countries for India when data for foreign aid is considered. Nepal is second to Bhutan in terms of foreign aid recipient country from India. While Bhutan receives almost half of the total foreign aid that India distributes to countries, Nepal's share has remained around 10 percent of the total fund. This year's budget has proposed an increment of almost 62 percent in foreign aid disbursement to Nepal from the Indian government when compared to last year's budget. The Indian government has allocated INR 10.5 billion foreign aid for Nepal in the upcoming fiscal year. Such allocation was at INR 6.5 billion in last year's Indian budget.



The average budget allocation for foreign aid to Nepal after FY 2000-01 remained at INR 2.64 billion. This, however, increased in the last ten years as average foreign aid commitment in this period is INR 4.2 billion. The realization of Indian commitment on foreign Aid shows mixed performances. In some instance just half of the committed foreign aid was disbursed to Nepal and in some cases more than the committed fund was also disbursed.

Conclusion

The Indian budget for FY 2019-20 could have a mixed impact for Nepal. It will influence formal as well as informal economy. Number of exportable products could adversely hit by increased customs duty in India. As there are no such exportable products on inputs and raw materials, Nepal will not be able to gain from the reduction in customs tariff in India. The Make in India campaign could, however, help ease the price level in Nepal. When the cost of Indian products reduces, Nepal will benefit from low import prices. In terms of Indian assistance, the Indian government has increased the budgeted assistance by almost two-third than last year.

Source:

1. 'Budget 2019-2020', Speech of Nirmala Sitharaman Minister of Finance, Government of India, July 5, 2019

2. Expenditure Budget 2019-20, Government of India

3. Macroeconomic Framework Statement 2019-20, Government of India

4. Medium Term Fiscal Policy cum Fiscal Policy Strategy Statement, Government of India

5. Budget Speech of Fiscal Year 2019/20, Government of Nepal, Ministry of Finance

6. Current Macroeconomic Situation of Nepal, Based on Annual Data of 2009/10, Nepal Rastra Bank

7. World Economic Outlook Database, 2019 April, International Monetary Fund

Annex: Some Facts and Figures of Indian Budget

Table A. 1: Indian Aid to Countries

	Amount in INR million			Composition			Growth	
	2017/18 Actual	2018/19 Revised	2019/20 Budget	2017/18 Actual	2018/19 Revised	2019/20 Budget	2018/19 Revised	2019/20 Budget
Aid to Countries								
Bhutan	25,901.40	25,100.00	28,017.90	54.38	41.17	36.95	-3.09	11.63
Afghanistan	3,659.60	4,700.00	4,000.00	7.68	7.71	5.28	28.43	-14.89
Bangladesh	780.20	1,200.00	1,750.00	1.64	1.97	2.31	53.81	45.83
Nepal	3,766.10	7,500.00	10,500.00	7.91	12.30	13.85	99.15	40.00
Sri Lanka	778.90	1,650.00	2,500.00	1.64	2.71	3.30	111.84	51.52
Maldives	1,092.40	4,400.00	5,760.00	2.29	7.22	7.60	302.78	30.91
Myanmar	2,235.50	3,700.00	4,000.00	4.69	6.07	5.28	65.51	8.11
Mongolia	4.20	20.00	50.00	0.01	0.03	0.07	376.19	150.00
Mauritius	3,503.90	6,600.00	11,000.00	7.36	10.82	14.51	88.36	66.67
Seychelles	2,231.60	1,000.00	1,000.00	4.69	1.64	1.32	-55.19	0.00
African Countries	1,727.20	3,300.00	4,500.00	3.63	5.41	5.93	91.06	36.36
Eurasian Countries	370.20	250.00	450.00	0.78	0.41	0.59	-32.47	80.00
Latin American Countries	199.50	100.00	150.00	0.42	0.16	0.20	-49.87	50.00
Other Developing Countries	1,223.20	1,250.00	1,500.00	2.57	2.05	1.98	2.19	20.00
Other	155.50	200.00	650.00	0.33	0.33	0.86	28.62	225.00
Total -Aid to Countries	47,629.40	60,970.00	75,827.90	100.00	100.00	100.00	28.01	24.37

Source: Expenditure Budget 2019, Government of India

Table A.2: Indian Budget at a Glance

				In Billion INR
	2017/18A	2018/19B	2018/19R	2019/20B
Total Expenditure	21419.73	24422.13	24572.35	27863.49
Recurrent	18788.33	21417.72	21406.12	24477.80
Capital	2631.40	3004.41	3166.23	3385.69
Resources	15509.11	18179.37	18228.37	20825.89
Revenue	14352.33	17257.38	17296.82	19627.61
Capital Receipts	1156.78	921.99	931.55	1198.28
Deficit/Surplus	5910.62	6242.76	6343.98	7037.60
Deficit Financing	5869.71	5812.10	5931.97	6527.01
Domestic Borrowings	5790.50	5837.99	5980.90	6556.53
Foreign Borrowings	79.31	-25.89	-48.93	-29.52
Cash Balance	40.91	430.66	412.01	510.59
Indian Budget in Billion USD				
				1 USD = 68.6 INR
	2017/18A	2018/19B	2018/19R	2019/20B
Total Expenditure	312.24	356.01	358.20	406.17
Recurrent	273.88	312.21	312.04	356.82
Capital	38.36	43.80	46.15	49.35
Resources	226.08	265.01	265.72	303.58
Revenue	209.22	251.57	252.14	286.12
Capital Receipts	16.86	13.44	13.58	17.47
Deficit/Surplus	86.16	91.00	92.48	102.59
Deficit Financing	85.57	84.72	86.47	95.15
Domestic Borrowings	84.41	85.10	87.19	95.58
Foreign Borrowings	1.16	-0.38	-0.71	-0.43
Cash Balance	0.60	6.28	6.01	7.44
Percentage Share of GDP				
	2017/18A	2018/19B	2018/19R	2019/20B
Total Expenditure	12.53	12.96	13.04	13.21
Recurrent	10.99	11.37	11.36	11.60
Capital	1.54	1.59	1.68	1.60
Resources	9.07	9.65	9.67	9.87
Revenue	8.40	9.16	9.18	9.30

Yak and Yeti Road, Durbar Marg G.P.O. Box: 20410, Kathmandu, Nepal
Phone: +977-1-4229985, 4229986, Fax:+977-1-4249158

Author:
Dr. Ravindra Prasad Pandey, Satyendra Timilsina, Archana Neupane
(Dr. Pandey and Ms. Neupane are Executive Director and Statistical Officer at the ISSR. Mr. Timilsina is a Ph.D. Scholor)

Publisher:
Institute for Strategic and Socio-Economic Research (ISSR) and Pavilion Group