Focussed spending, but deficit a concern

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While the need to push growth can be a good excuse, slipping frequently on the fiscal deficit undermines credibility

Budget 2018-19 had to be presented against a background of several concerns. These concerns included a slowdown in growth, falling investment rate and rising discontent in agriculture. The Budget has addressed these concerns, partly directly and partly indirectly. The high point is on expenditures particularly in agriculture, rural development and infrastructure. The impact of the budget on the economy will depend on how well-tuned these expenditure programmes are and how well they are implemented.

It is easy to be expansionary. But the critical question is how close the Government stays with the path of fiscal consolidation. For 2017-18, the budget deficit according to the Revised Estimates will be 3.5 per cent of GDP as against 3.2 per cent announced earlier. The justification for the slippage is that GST collection for this year will be for only 11 months and this results in a shortfall in revenue realisation. For 2018-19, the budget deficit is fixed at 3.3 per cent as against 3 per cent indicated in the glide path for fiscal consolidation.

Do these slippages matter? Given the need for pick-up in growth, one can justify these shortfalls. However, slipping year after year from the announced path undermines the credibility of numbers. The acceptance of NK Singh Committee's recommendations in its original form would in fact impose a heavier responsibility. The 3 per cent-rule has a strong logic behind it. It is consistent with the household sector's saving in financial assets and its allocation among different deficit sectors. Interest payments as a ratio of revenue receipts of the Centre in 2017-18 stood at 35.3 per cent.

As it is, it is a large preemption. A rise in borrowings puts pressure on interest rate as well. There are also questions regarding what is excluded from the deficit. For instance the recapitalisation bonds of public sector banks are excluded. The revenue deficit within fiscal deficit remains high. The Government cannot let another year of slippage in fiscal deficit. If that happens, it will bring into doubt government's commitment.

Revenue projections

The quantum of fiscal deficit is closely related to revenue projections. Very optimistic revenue projections will make the fiscal deficit number suspect. Gross tax revenue is expected to increase in 2018-19 over revised estimates of 2017-18 by 16.7 per cent, which is indeed high, given an expected normal GDP growth of 11.5 per cent.

Thus the buoyancy works out to be 1.45. The expected year on year increase is also higher than in the current year. In recent years, the buoyancy has increased. Even then, to expect gross tax revenue to GDP to rise from 11.6 per cent to 12.1 percent seems optimistic. It is true that how GST will behave in terms of revenue collection is not clear. The Government will have to keep a close watch on this.

Expenditure budgeting

As mentioned earlier, the major emphasis of this Budget is on expenditures in select sectors. It is, however, seen that total expenditures in 2018-19 are expected to rise only by 10 per cent over revised estimates of 2017-18. Within it, capital expenditures are also expected to rise by the same percentage. Capital expenditures as a ratio to GDP will remain the same both in 2017-18 and 2018-19 at 1.6 percent. In fact, this would be lower than the ratio in 2016-17 which stood at 1.8 percent of GDP. This means many of the programmes outlined in the budget will be funded by extra budgetary sources. It remains to be seen whether the required resources outside the budget can be raised and what its impact will be on interest rate.

Two of the expenditure programmes need clarity. One relates to the announcement that in the case of all crops, the minimum support price (MSP) will be 1½ times their production cost. It is not clear what the term the 'production cost' means. If the term includes all inclusive costs including rental of the land, there can be a substantial jump in MSP. It will have implications both for the budget and for food inflation. It is also not clear whether in the case of all crops there would be an open ended procurement at MSP.

In that case, procurement will have to be supplemented by a public distribution system to sell off the procured commodities. The Finance Minister has also talked about the measures needed to support farmers under conditions when the market price falls below the MSP. If there is no open-ended procurement, the choices are a limited procurement to absorb the excess supply that might have caused the price to fall, or to compensate farmers with the difference between the MSP and market prices. Once again, it is not clear which course the Government will follow and what the consequent cost will be.

The announcement of the National Health Programme Scheme is a bold step forward. It is supposed to cover 10 crore of poor families and the coverage is up to 5 lakh per family per year. The cost of this programme is not fully budgeted. Perhaps, it might take a year for finalising the scheme. If it is going to be an insurance scheme, determining the premium is going to critical.

The supply-side arrangements to take care of the patients is also another issue that needs to be resolved. Of the three major items of subsidies, only in the case of food, subsidy has been increased by 20 percent. In the case of fertilisers and petroleum, subsidies remain more or less at the current year's level. Particularly in the case of petroleum, there can be an increase if the crude oil price rises further.

Tax measures

On taxation, there are no major changes. The reduction in corporate tax rate is confined only to a sub set. Changes in personal income tax are minimal. The introduction of standard deduction will help the salaried class. But they have to forego some of the benefits they are getting now. The one change that has caused already a turmoil in the stock market is the long term capital gains on equities. However in principle, there can be no objection to the proposed change.

Perhaps, the Government could consider whether indexation may be permitted while calculating capital gains. The increase in cesses is purely a revenue raising measure. There is no accounting on how much of this is spent on the programme in the name of which the cess is raised. The Government has also decided to increase the customs duty on a number of items. If there are instances of dumping, the Government should seek a remedy through the appropriate provisions available under the WTO arrangmenet. It is somewhat odd that after the Prime Minister's lecture on protectionism at Davos, the Government have chosen to raise the import duty on several items.

Budget and growth

The critical question to pose is whether the budget will accelerate growth. A disquieting factor about the economy has been the fall in investment rate. Gross Fixed Capital Formation stands at 26.0 per cent currently as against 33 per cent in 2007-08. This is a steep fall. This has to be reversed. Capital expenditures by the Government itself are not normally high.

In fact, bulk of the public investment comes from the public sector undertakings and, therefore, for public investment to act as a catalyst, one needs to know more about what PSUs will do. There is nothing in the budget to stimulate corporate investment except the measures announced to benefit MSMEs. Certainly, some of the expenditure programmes focused on rural development and agriculture will lead to a pickup in rural demand. The external demand may also pick up as world trade is expected to grow faster in 2018.

For growth to accelerate, the investment rate must go up. Perhaps if the overall climate for investment improves, this will happen. Speedy implementation of projects announced in the budget will help in this regard. Continued vigilance on fiscal deficit is a must, if stability along with growth is to be ensured.

The writer was chairman of the Prime Minister's Economic Advisory Council and governor of RBI

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