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A well-intentioned Budget

c rangarajan

The Budget, based on credible revenue estimates, seeks to boost investment and demand. But implementation is the key

Every budget is influenced by the initial conditions. This is all the more so with respect to Budget 2017-18. It had to be framed against the background of falling economic growth and the distortions caused by demonetisation. Both these issues had to be addressed firmly.

That the Budget takes this task into consideration is seen by the repeated emphasis by the finance minister in his speech on the need to raise investment and consumer demand. Thus, public expenditure is the focus. One positive feature in the initial conditions is that stability parameters such as consumer and wholesale price inflation and current account deficits are under control.

Fiscal deficit

While recognising the need to stimulate the economy, the Budget prudently keeps the fiscal deficit as a proportion of GDP at 3.2 per cent in 2017-18. This is lower than the current year's deficit of 3.5 per cent and slightly higher than the 3 per cent indicated earlier. Given the extraordinary circumstances, this relaxation from 3 per cent may be justified even though this should not become a precedent.

From the speech, it is learnt that the fiscal management and budget management (FRBM) review committee had recommended treating debt-to-GDP ratio as the target, and that as far as the Centre is concerned, it should be brought down to 40 per cent by 2023. The speech also mentions that the committee had recommended 3 per cent fiscal deficit for the next three years to achieve the targeted goal.

In my view, focusing on fiscal deficit is preferable, since it is the deficit which leads to borrowing and adds to debt. There is strong logic behind the prescription of a budget deficit of 3 per cent for the Centre and 3 per cent of GDP for all the States together. This is consistent with household savings in financial assets which, if anything, in recent years has been declining. In 2016-17, the Centre's interest payments constituted 46.7 per cent of its net tax revenue. This is a large pre-emption, leaving very little for all other expenditure. Therefore, there is need to contain fiscal deficit and consequently reduce debt-GDP ratio. Too many pause buttons using 'the escape clause' will only make a mockery of the FRBM Act in its present or any amended form.

Revenue projections

Even though the core of the Budget centres around expenditure, there is need to examine whether the revenue projections are reasonable and are likely to hold. Compared to the actuals of 2015-16, the revised estimates for gross tax revenue for 2016-17 show a rise of 17 per cent. The Budget projects an increase in gross tax revenue of 17.2 per cent in 2017-18 over the Budget estimates of 2016-17.

However, over the revised estimates of 2016-17, the rise is 12.2 per cent. With projected nominal GDP increase of 11.75 per cent, tax buoyancy is a little over one. As a proportion of GDP, gross tax revenue is expected to touch 11.3 per cent. We have still some distance to travel to catch up with the level of 11.9 per cent reached in 2007-08. Non-tax revenue shows a small decline in 2017-18 compared to 2016-17. On the whole, the revenue projections have been done conservatively and therefore will hold.

The tax structure remains by and large unchanged. As far as indirect taxes are concerned, pending introduction of the Goods and Services Tax (GST), the finance minister has not proposed any changes. In fact, he could have taken the opportunity to clean up the indirect tax structure, as far as the Centre is concerned, in tune with the consensus already reached in the GST Council.

There was much expectation in relation to corporate tax. But the finance minister has limited the reduction to 25 per cent from 30 per cent only for MSME companies. Though in terms of number of companies, MSMEs may dominate, this is not true in relation to output. In difficult circumstances, MSMEs do need support.

In relation to personal income tax, there is only one change. The tax rate in the lowest slab has been brought down while a cess has been added to the income bracket of ₹ 50 lakh to ₹ 1 crore. The finance minister has withstood the demand to raise the exemption limit. This is welcome, as the need is to widen rather than to reduce the tax net.

There are a few other changes which go to benefit participants in the financial market as well as some modifications with respect to capital gains and housing. On the whole, the changes are minimal and may be a welcome development. At a more suitable time, some of the reforms in the tax structure such as Dividend Distribution Tax, must be addressed. In order to reduce corporate tax in general, exemptions have to be knocked off. This is not easy. But the Government must come forward with a tentative list and test the waters.

Expenditure allocation

Expenditure outlined in the Budget aims to raise investment and increase consumer demand. It can be partitioned into revenue and capital to understand how much is going into consumption and how much into investment. Alternatively, it can be classified according to objectives:(a) those aimed at accelerating growth directly (capital expenditure falls in this category); (b) those aimed at increasing consumption demand; and (c) those viewed from a social welfare angle.

The projected growth in capital expenditure for 2017-18 is 25.4 per cent over the BE of 2016-17. This is indeed a substantial increase but the growth is much less over RE. Even after this increase it constitutes only 1.8 per cent of GDP. Nevertheless, the emphasis on infrastructure expenditure is welcome. In fact, a good part of the public investment comes from public sector enterprises which are not part of the Budget. A detailed listing of expected investment by PSUs would indeed be helpful and would contribute to improving investment sentiment in the private sector.

There is a fairly large list of programmes and schemes indicated in the Budget speech, particularly in the areas of agriculture and rural development. Many of them are extensions of existing ones. In fact, in the case of some programmes, the increase over the RE of 2016-17 is not large. For example, in the case of the MGNREGS, the allocation for 2017-18 is ₹ 48,000 crore as against the RE for 2016-17 of ₹ 47,499 crore. But the BE for 2016-17 for this was ₹ 38,500 crore. Nevertheless, this expenditure adds up to a substantial amount. But the impact depends on how well the allocations are spent. The pick-up in rural demand rests heavily on this.

The Budget includes measures towards curbing black money, reforming the political funding system and expanding the use of digital transactions. All these are welcome steps. Private corporates (except MSMEs) may not find any direct incentive for investment. If, however, the overall investment climate picks up because of higher growth, it will be of help. While there are possibilities of a cut in interest rate, the banks themselves are under stress. One should not expect too much.

Final look

The adverse impact of demonetisation will wear off as currency availability approaches normalcy. But some effects will not go away. Sectors such as real estate will have to rethink how to run their business.

The Budget is well-intentioned. But actions must match intentions. In the final analysis, implementation is key. Jobs will come only out of growth spurred by new investment. There is need to assiduously develop the climate for investment. In this effort, the Budget is the first step.

The writer is a former chairman of the Economic Advisory Council to the Prime Minister and former governor of the RBI

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