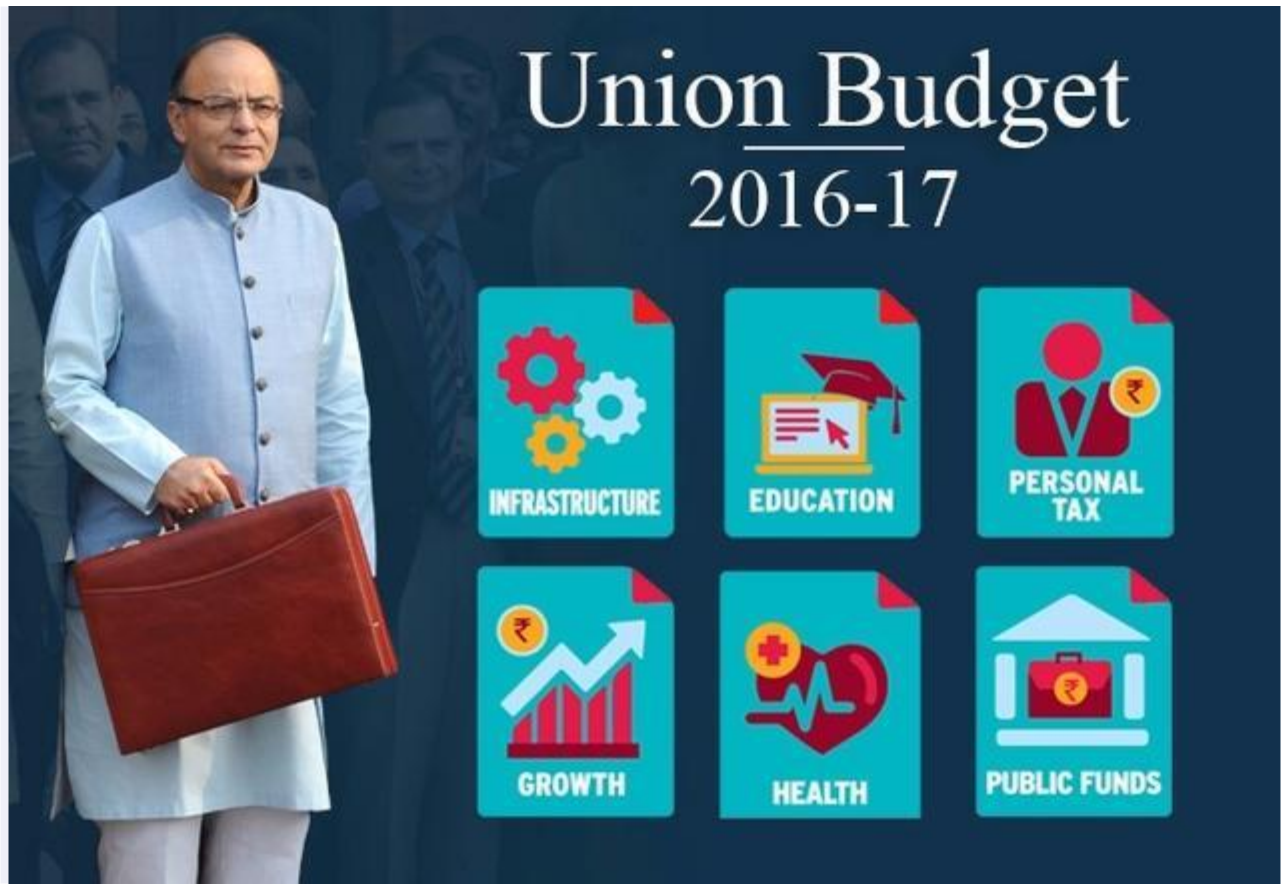
March 8, 2016
Updated: March 8, 2016 01:50 IST

Full marks on fiscal deficit

- C. RANGARAJAN

COMMENT · PRINT · T T

inShare



TOPICS
Budget 2016
economy, business and finance

There is some fear of overestimation of revenues and underestimation of expenditures in the Budget. But the decision to stick to fiscal consolidation sends out a clear message that the goal is to accelerate growth under conditions of macroeconomic stability

The high point of the Budget for 2016-17 is its adherence to the road map for fiscal consolidation by fixing the fiscal deficit at 3.5 per cent of the gross domestic product (GDP). This is an extremely welcome step and sends out a clear message that the goal of the government is to accelerate growth under conditions of macroeconomic stability. However, in this context, two different questions arise.

One is about the credibility of this commitment and the other, a more fundamental one, is whether it is necessary at all to adhere to a fixed road map.

Fiscal deficit


C. Rangarajan

On credibility, let us look at the numbers. Total expenditures are projected to increase by 10.8 per cent. However, it is not clear to what extent the burden of the Seventh Pay Commission has been taken into account. It appears that a significant part of the burden has been left out. As and when the government takes a final decision, it can very well happen that the total expenditures will rise. Thus, there is some fear of underestimation as far as expenditures are concerned. On the revenue side, gross tax revenue is projected to grow by 11.7 per cent against a backdrop of the nominal GDP growing at 11 per cent. This is a reasonable assumption. However, receipts from disinvestment in 2016-17 are estimated at Rs.56,500 crore as against an actual collection of Rs.25,300 crore in 2015-16. The projected receipts of Rs.99,000 crore from spectrum auction in 2016-17 are also way above what was obtained in 2015-16. There might thus be an overestimation of revenues. Therefore some doubts persist around the fiscal deficit target of 3.5 per cent.

As for the need for containing the fiscal deficit, it is important to note that sustained high fiscal deficits not only lead to a rise in the debt-GDP ratio but also to an increase in interest payments as a proportion of revenues, leaving less for productive expenditure. As a percentage of net tax revenues to the Centre, interest payments have jumped from 38.9 per cent in 2007-08 to 46.7 per cent in recent years. For2016-17, the Budget retains it at the same level. It is a good sign that the ratio remains the same despite the revenue base coming down because of increased devolution to States. Without a conscious effort to contain fiscal deficit, this ratio will only keep rising.

There is also another angle from which the impact of high fiscal deficit can be looked at. Under the Fiscal Responsibility and Budget Management Act, 2003, the mandated target for the Central government is 3 per cent of GDP. The States taken together will also take another 3 per cent of GDP. Thus the combined fiscal deficit of the Centre and the States will be 6 per cent of GDP. Both private business and government are deficit sectors in the sense that they invest more than they save. They draw on the surplus of the household sector. Household sector savings in financial assets which are called transferable savings used to remain at 11 per cent of GDP. The mandated fiscal deficit of 6 per cent was consistent with this level of household savings in financial assets. But household savings in financial assets have come down to almost 7.3 per cent of GDP. This leaves very little for sectors other than government (including public sector enterprises) to draw on the surplus of the household sector. Thus, there is considerable merit in favour of moving towards the target of 3 per cent of GDP. In fact, so far the government has not taken a 'rigid' position on fiscal deficit. The fiscal deficit for 2015-16 is almost 1 per cent above the mandated level. Flexibility should not mean undercutting the basic principle.

Public spending

The major thrust of the Budget speech was in outlining the various schemes of public spending in agriculture, infrastructure and social sectors. It is not uncommon to push for public expenditure at a time when private investment sentiment is weak. With reference to public spending, there are two issues. The first relates to the design of schemes. Sector experts need to examine carefully how well the proposed schemes meet the needs of the sector. The second and more important issue relates to the ability of the government to ensure that the schemes are actually implemented on the ground. It may also be noted that while a large increase in capital expenditure on infrastructure has been contemplated, a significant proportion of the financing will come from "extra budgetary resources", which means borrowing. This will be over and above what the government is borrowing. Capital expenditures of the government showed a steep rise this year. But in 2016-17, the rise has been projected at only 3.9 per cent.

To do away with the distinction between plan and non-plan expenditure is a suggestion that was made by a committee headed by me some years ago. Later the Fourteenth Finance Commission also endorsed this idea implicitly. When the suggestion was originally made, it was not to weaken planning but to strengthen it. This distinction had the unfortunate effect of having schools without required teachers or hospitals without adequate doctors because one is treated as plan and the other non-plan. What was proposed was that policymakers must take a holistic view of the expenditures required by a sector or programme and allocate resources.

There are minimal changes in relation to taxation. The expectation of a change in corporate tax rate has been belied. The proposed reductions are limited to a small subset of companies. The changes in tax exemptions are more in the nature of modification than elimination. The decision to levy a tax on those who earn dividend income above Rs.10 lakh and the increase in surcharge on people whose income is above Rs.1 crore by 3 per cent to 15 per cent are both welcome from the point of equity. The measures to reduce litigation and simplify procedures are steps in the right direction. They need to be part of an ongoing programme.

Growth and reforms

Will the Budget help accelerate growth? Increased spending on agriculture and rural development besides increasing agricultural output may push up rural demand for manufactured goods. There is also the hope that after two years of drought, the monsoon will be good in the coming fiscal. The additional spending on infrastructure may draw in private investment. Apart from these, there are no direct measures to stimulate private investment.

As far as reforms are concerned, there are references to new pieces of legislation relating to Aadhar, dispute resolution in public-private-partnership projects and modifying the Motor Vehicles Act. Important pieces of legislation such as the Goods and Services Tax Bill and Insolvency and

Bankruptcy Code are already caught in the political logjam. Under the circumstances, the government must move strongly in the area of administrative reforms so that cumbersome procedures are eliminated and the administrative machinery, including the delivery system, functions more efficiently. These are low-hanging fruits which can be plucked. The ease of doing business is influenced by how well the government functions.

The decision to stick to the path of fiscal consolidation is a wise one. It will send out the right signals to the investors. The impact of high public spending will depend upon the drive and efficiency with which the new projects and programmes are taken up and executed. Implementation is the key to boosting investor confidence.

(C. Rangarajan is former Chairman of the Economic Advisory Council to the Prime Minister and former Governor, Reserve Bank of India.)