The Budget: A Good Balancing Act

Milestones are set - but the roadmap is not clear

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The Budget is more than a statement of accounts. It is a policy statement. That is why the first budget of the new government was looked forward to with great expectations. In many ways, the expectations have been fulfilled. But some fundamental issues remain unresolved.

A budget can be analysed from three stand points. First is its impact on the economy which is mainly through the fiscal deficit. This will indicate how expansionary the fiscal policy is. The second relates to the expenditure pattern. This gives an idea of the expenditure priorities of the government. Third is the tax design which affects the tax payers' ability and willingness to save and invest.

Fiscal Deficit:

The main message that comes through from the budget is the commitment to fiscal consolidation. The Finance Minister has decided to stick with a fiscal deficit of 4.1 per cent of the GDP as indicated in the interim budget. There is also a commitment to take it down to 3.6 per cent next in the fiscal and to 3 per cent the year after. This is sought to be achieved by raising the tax / GDP ratio from 10.2 per cent in 2013-14 to 10.6, 10.9 and 11.2 per cent in the subsequent three years.

It is important to recognize the critical role played by the fiscal deficit. A sustained level of high fiscal deficit leads to growing debt and interest payments become larger and larger. As of 2013-14, interest payments constituted 45.5 per cent of the net tax-revenue of the Centre. Also, a high level of borrowing by the government reduces the space available for the private sector. The savings in financial assets of the Household Sector, which is the only surplus sector in the economy, are now around 10 per cent of GDP. A combined fiscal deficit of the Centre and States at 6 per cent of GDP seems in this context reasonable. Without any restriction on the fiscal deficit, budget making is the easiest exercise.

The Budget for 2014-15 is postulated on the assumption that the tax revenue will grow at 19.8 per cent. Real GDP is expected to grow between 5.4 per cent and 5.9 per cent. Therefore nominal income may grow around 13 per cent. This itself implies a high level of inflation. With this rise in nominal income, the expected tax buoyancy is around 1.4. Achieving the presumed tax revenue appears to be a hard task.

There was a certain apprehension about the tax revenue projected in the interim budget. It persists even now. In fact, with the tax concessions announced in the current budget, there is a reduction in the tax revenue of Rs. 9000 crore. Expenditures contemplated show an increase of Rs. 31,000 crore. Thus the shortfall increases by Rs. 40,000 crore. This has been offset by a substantial increase in non tax revenue. Disinvestment is now pegged at Rs. 63,000 crore. Dividend contribution from the RBI goes up by Rs. 13,000 crore. It must be noted that any outflow from the RBI has an expansionary effect. Taking all these factors into account, it appears that achieving the fiscal deficit of 4.1 per cent is going to be difficult. If the government is serious on adhering to the fiscal deficit target, it must be willing to cut expenditures as revenues fall short of budgeted levels. Pruning of expenditures must be done in such a way that this has the least adverse impact on the economy. New projects must be held over and available resources must be utilized to complete the existing projects. In short, *an alternative expenditure programme must be ready on hand*.

Expenditure Patterns:

The expenditure announcements include many new projects. Each project, taken by itself, is important and valuable. But some caution is needed here. Government's investment expenditure should not be spread out thin over several projects. Under the present circumstances, public sector investment can play a catalyst for private investment. Therefore, utilizing funds available to complete existing projects must take priority. It is good that an allocation of Rs. 37,880 crore has been made for road development. The initiative to set up a venture capital fund for start-ups is also extremely welcome. There are indeed several measures aimed to stimulate private investment such as those relating to FDI. One of the suggestions has been to allow banks to float long term bonds which may be utilized for long term lending for capital expenditures. My own preference would be to revive the earlier system of development finance institutions. At that time, we had a network of development finance institutions at the state level and one or two at the national level. We moved over to the universal banking system from this model. This worked reasonably well but the banking system is reaching the limits in terms of group and sector exposures. Our hope that the capital market will develop and equity and debt funds will be available for long term capital expenditure has not materialized. It is in this context, a relook at the earlier system may be in order.

Tax Design:

Most of the tax proposals made in the budget are welcome. They reflect good homework. Several of them are in the nature of clarifying and introducing transparency, as in the case of transfer pricing. A low withholding tax on all bonds issued by Indian corporates abroad is welcome. Lowering the limit for investment allowance is very much justified under the present circumstances. The incentives for the promotion of savings are well calibrated.

What is missing?

In many ways, the present budget is a continuation. There is continuity in numbers as well as in philosophy. The changes that have been made are largely in the same spirit in which measures were introduced earlier. A few policy actions could have made this budget stand apart. There is no doubt about the strong commitment to fiscal consolidation in the budget. There are indications of what needs to be achieved not only in this year but also in the subsequent years. Subsidies are to be reduced from 2.3% on GDP last year to 2 % in the current year and 1.7 % and 1.6 % in the next few years. Apart from expressing the need that the subsidies should be more targeted, there are no specific action points. In fact, in one of the associated documents, it is mentioned, "With rising fuel subsidy, there is a need to cap the subsidized cylinders at a more realistic level". Specific action in this area would have strengthened the credibility of the budget. Thus in one sense, the milestones are set but the road map is not that clear.

In the recent period, it has been seen that despite a high investment rate, income growth has been moderate. This is primarily because of the delay in the completion of projects. Apart from the bottlenecks at the micro level, issues relating to the environment and land acquisition have assumed importance. These are issues which have to be resolved at the national level rather than at the level of individual projects. Similarly policies relating to coal mines and their exploitation need new orientation. Maybe, we have to wait for these policies to emerge in the subsequent months.

The budget has been framed under difficult circumstances. Growth has to be stimulated without sacrificing the stability parameters relating to fiscal consolidation, inflation and the balance of payments. In a broader sense, the budget has strived to find solutions to most of the immediate issues. Several measures introduced will stimulate private investment and economic activity. But there are important policy decisions which are needed to be addressed for sustained high growth. On the question of fiscal consolidation, greater clarity on how to control subsidies needs to emerge. Equally important are decisions on the environment and land acquisition. The government must work out a comprehensive policy which strikes a proper balance between the compulsions of growth and the concerns relating to the environment and land acquisition. The sooner this is done, the better.

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