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Opinion

Can the Budget reverse the slowdown?

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Tax revenue uncertainty, excess borrowings largely to meet revenue expenses, and Centre's limited commitment to NIP aren't encouraging.

In assessing the potential role of Union Budget 2020-21 in reversing the ongoing economic slowdown, four questions are pertinent: Will the Centre's tax performance be even lower than the already lowered revised estimates (RE) for 2019-20? What is the true extent of fiscal deficit, if off-budget borrowings are also taken into account? Is the slippage in fiscal deficit being put to the most effective use, enabling a reversal in slowdown? and To what extent is the proposed national infrastructure pipeline (NIP) genuinely growth-promoting?

Centre's tax performance

The Budget was frank enough to keep the annual growth in the Centre's gross tax revenues in 2019-20 RE at 4 per cent against a projected growth of 18.3 per cent in the budget estimates (BE) of the Budget presented in July 2019. However, the actual tax revenues may fall short of even this lowered target. As per CGA data covering the first three quarters of 2019-20, there is a contraction in the Centre's gross tax revenues of (-) 2.9 per cent.

This implies that in the last quarter of 2019-20, a growth of 19 per cent over the corresponding period of 2018-19 is required to achieve the full year growth of 4 per cent as envisaged in the RE. Such a high growth in the last quarter has not been achieved in recent years. Considering individual categories of taxes, this task appears quite uphill.

In the case of personal income tax (PIT), to meet the full year RE, a growth of 51.6 per cent is required in the last quarter of 2019-20. In the case of indirect taxes, a growth of 18 per cent is required against an actual growth performance of only 0.1 per cent in the first three quarters. At this point, it is not clear how much of the telecom dues will help to offset the decline. If 2019-20 actual revenues, which would serve as the base for 2020-

21, are lower than the RE, it would upset the 2020-21 BE projections. This revenue uncertainty would also affect the fiscal deficit projections.

What is the real fiscal deficit?

According to the BE, fiscal deficit has slipped by 0.5 per cent points of GDP each in 2019-20 and 2020-21 as compared to the previously announced targets at 3.3 per cent in 2019-20 and 3 per cent in 2020-21 under the Fiscal Responsibility and Budget Management (FRBM) Act.

This slippage takes the fiscal deficit to 3.8 per cent and 3.5 per cent of GDP, respectively, for these two years. However, the true fiscal deficit is significantly larger if we take into account off-budget borrowing, which is referred to as extra-budgetary resources (EBR), and the borrowing from National Small Saving Fund (NSSF). The relevant numbers are given in the appendix to the FM's Budget speech for 2020-21.

Off-budget borrowings relate to borrowings done by various special purpose vehicles (SPVs) attached to different ministries where the entire burden of servicing the additional liability is on the Central government, that is, on the budgetary resources. In recent years, the Centre has been using the Food Corporation of India (FCI) to borrow from the NSSF in lieu of the due payment of food subsidy. The FCI borrowing from the NSSF amounts to substitution of financing of government's subsidy expenditure such that it is not included in the Centre's fiscal deficit.

In fact, not only the entire burden of servicing this additional borrowing is to be borne by budgetary resources but such borrowing is shown as part of government's liability. If we add these two elements, namely, the EBR and FCI's NSSF borrowing, the true fiscal deficit in 2019-20 amounts to ₹9,21,430 crore, that is, 4.5 per cent of GDP. In this, the EBR component is ₹44,584 crore and the NSSF component is ₹1,10,000 crore.

In 2020-21, the estimated true fiscal deficit amounts to ₹9,82,437 crore, consisting of ₹49,500 crore of EBR and ₹1,36,600 crore of the NSSF component. This takes the projected fiscal deficit for 2020-21 to 4.4 per cent of GDP. It is a welcome move by the Finance Minister to provide these data explicitly, thereby bringing some transparency in the matter.

This has two implications: One, those who argue that expenditures must have been increased even beyond what the Budget has provided must be conscious of the full implications for fiscal deficit of such an expansion. And, two, with net financial savings of the household sector going down, higher fiscal deficit will have less savings for private investment unless the latter is financed by funds from outside.

What is the extent of stimulus?

Slippage in fiscal deficit may be justified in the context of the ongoing slowdown, if it is used for effective stimulation. It is notable that out of the slippage of 0.5 per cent points of GDP in the fiscal deficit from the corresponding targets in 2019-20 and 2020-21, only 0.1 per cent point in each year have been used for augmenting capital expenditure. The government's capital expenditure relative to GDP has increased from 1.6 per cent in 2018-19 to 1.7 per cent in 2019-20 RE and from 1.7 per cent to 1.8 per cent in 2020-21 BE. In both years, therefore, the increase of 0.1 per cent points of GDP implies that 80 per cent of the officially recognised slippage in fiscal deficit has been used for revenue expenditure or non-asset forming expenditure. Recent estimates of government expenditure multipliers indicate that the highest multipliers are associated with capital expenditures. Those associated with revenue expenditures are rather low.

For example, a recent RBI (2019) study estimates the capital expenditure multiplier at 3.25. Similarly, studies by Bose and Bhanumurthy (2013) and Goyal and Sharma (2015) estimate these at 2.45 and 2.38 respectively. The point we are making is that it would have been far more effective if the bulk of the budget deficit had been utilised to finance capital expenditures. Even presentationally, it would have been useful if the FM had provided a consolidated statement of capital expenditures by the Central government and major public sector enterprises.

Another kind of stimulus is introduced through foregone tax revenues such as through the PIT rate options and the changes in the dividend distribution tax. The estimated revenue cost of these measures at ₹40,000 crore and ₹25,000 crore are rather small as stimulus measures. In any case, their impact depends on the extent to which these lead to an increase in demand.

What's the additionality in NIP?

The most ambitious and potentially expansionary investment demand stimulation can come from the proposed NIP. In terms of absolute amounts, the total investment of ₹102 lakh crore appears quite large. This is a medium-term expansion plan covering the six-year period 2019-20 to 2024-25. Its financing is to come from the Central government, CPSEs, State governments, SPSEs, and the private sector.

Of these, it is the Central government's non-defence capital expenditure, which is pivotal. This is meant to leverage the investments from the State governments and their public sector enterprises and the private sector. What matters for measuring the extent of stimulation is the additionality in investment over and above the current levels of government investment on infrastructure.

Examining the proposed investment path over the six-year period, the Centre's average per year budget-based investment amounts to 0.9 per cent of GDP. This may be compared with the actual non-defence capital expenditure of the Central government in recent years, which is 1.1 per cent of GDP on average per year.

The proposed NIP may not constitute an additionality in the form of non-defence capital expenditure financed by the Central budget. The contribution of State governments and the private sector depends on their own resources and the nature of the projects they invest in. What is needed is an additionality to capital expenditures by the Central government, that is, over and above what would have been normally invested.

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