Is This Budgetary Shrug Really a Nudge Enough for Private Investment to Pick Up?

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The Union Budget 2020-21 was looked forward to with great expectations. Growth rate for 2019-20 was estimated at 5%, the lowest in a decade. The fixed capital formation rate had fallen from 34.3% of GDP in 2011-12 to 27.8% in 2019-20, a steep decline of 6.5%, reducing the potential growth rate by 1.6%.

The budget was expected to address these problems. Have these expectations been fulfilled?

Overall, the budget is well-intentioned, even though it does not use the word 'slowdown' even once. It outlines, in extenso, the multiple objectives it seeks to achieve. While the expenditure programmes may show how demand will be revived, the revenue projections, along with the fiscal deficit, will indicate whether these expenditure programmes are sustainable.

While the fiscal deficit in the current fiscal goes up to 3.8%, the projected fiscal deficit for 2020-21 is 3.5%. While these levels are above the implicit mandate of 3% of GDP, they may be condoned, given the need to raise government expenditures to stimulate demand. However, the critical question is whether the 3.5% fiscal deficit will stick.

The nominal GDP in 2019-20 is assumed to grow by 10%. This is realistic. The gross tax revenue is assumed to grow by 12%. Thus, the buoyancy is greater than one that did not materialise in the current year. The reliance on disinvestment is high, even after allowing for LIC disinvestment.

The finance ministry will have to monitor the revenue growth so that expenditures must be adjusted such that the fiscal deficit can be maintained. In fact, taking the expenditures as given, the possibility of GoI exceeding the budget's fiscal deficit is very much there. The escape clause should be seen as permitting GoI to exceed by 0.5% the implicit mandate of 3%, rather than over and above what is budgeted.

It is hoped that GoI would not by invoking the 'escape clause' and ask RBI to enter the primary market in government paper. That will tantamount to monetising directly the fiscal deficit.

Has she aimed too low?

Some of the changes in the tax regime are significant. A major effort was made some months ago to cut the corporation tax rate. In this budget, some steps have been taken in the direction of simplifying personal income tax (I-T). The impact of this may be very limited. In fact, the broad principle of reducing the tax rate along with withdrawing exemptions must be taken to the logical end and must cover the entire gamut of personal I-T. We should move towards a single regime rather than give options.

Bulk of the time was spent by the FM on explaining the various programmes in different sectors. Quite clearly, sectoral experts must examine how relevant these expenditures are. More importantly, much depends on how they are implemented. The overall expenditures show a rise of 12%. Within that, capital expenditures are expected to increase 18%. However, the ratio of capital expenditures to GDP stays at 1.8%, which is the average over the past few years.

The financial sector has come in for special treatment. Reforms are needed to strengthen the financial system and move it forward. As far as the banking system is concerned, the crucial question is not so much mergers as the extent of the total banking system, which the public sector wants to own. The action relating to the Industrial Development Bank of India gives us some idea. But more clarity is needed.

The second important reform measure is to determine the 'arm's length' between GoI and the board of management of public sector banks. Efficiency is a function not only of technology, but also the structure of the organisation.

It is a moot point if the proposed government expenditures will stimulate demand. The room available for GoI is limited. Also, expenditures lack focus. As for stimulating investment, GoI's own participation is still limited. In fact, in 2020-21, of the total fiscal deficit of 3.5%, revenue deficit is 2.7%. The driver of deficit is not investment. Much of the overall capital expenditure of GoI comes from extra-budgetary resources. Therefore, a lot depends on the pick-up in private investment. Will the budget help to create a favourable investment sentiment? We have to wait and see.