Essay

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THE STING IN THE BUDGET

EXPERT VIEW

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The Union budget for 2016-17 was presented last month amid some concern about the state of the economy. There is a slump in domestic investment with little prospect of revival on the horizon. There is a drop in the dollar value of exports. There is stagnation in agriculture coupled with rural distress. There is a contraction in manufacturing at home. Obviously, growth is being sustained by the services sector. This is juxtaposed with a global slowdown. In this situation, growth in output and employment can only come from a revival of domestic investment and domestic consumption.

The finance minister had choices to make and constraints to face. The sharp drop in inflation, attributable largely to the collapse in world crude oil prices, opened a window of opportunity that is a real blessing. It created the space for a counter-cyclical budget that could have used fiscal expansion as a stimulus for growth. However, revenue receipts from taxes were squeezed, following acceptance of the Finance Commission recommendations, as the centre's share of tax revenues dropped from 68% in 2015-16 to 58% in 2016-17. The allocations for expenditure on salaries and pensions were bound to jump significantly, on account of the Pay Commission recommendations and the one-rank-one-pension decision for the armed forces. Of course, the low world crude oil prices provided some compensation by increasing the fiscal space available.

The decision to peg the fiscal deficit at 3.5% of GDP became the keystone in the arch for the budget exercise, for it imposed a ceiling on the amount by which the government could allow its expenditure to exceed receipts. The unstated casualty was the quality of fiscal adjustment. In 2016-17, as compared with 2015-16, as a proportion of total expenditure, revenue expenditure is budgeted to rise from three-fourths to almost nine-tenths whereas capital expenditure is budgeted to fall from one-fourth to just over one-tenth. This mix of consumption and investment in government expenditure is bad news, just as it would be for a household or a firm. There would have been only two ways of doing better: either increasing borrowing by the government, which would have enlarged the fiscal deficit, or increasing revenue receipts through taxes. But there were concessions on direct taxes, while the modest additional resource mobilization was in the form of higher indirect taxes, which are regressive in their burden.

The arithmetic of the budget is, as always, creative, with overestimated revenues and underestimated expenditures, so that the comfort of fiscal consolidation in conformity with the target might be illusory. The income tax projections are over-optimistic but the real problem lies in other non-tax revenues (projected to increase by 46%, more than ₹50,000 crore, from spectrum sales) and miscellaneous capital receipts (projected to increase by 123%, more than ₹30,000 crore, through disinvestment, asset-sales, strategic or otherwise). The provision for expenditure on higher salaries and pensions is unspecified while the subsidies bill is understated. It would seem that old habits die hard in the ministry of finance!

In my judgment, there are three attributes of this budget, discernible between the lines in the speech, which I would like to highlight for an overall evaluation.

First, the text is long on minute details but short on a broader vision, so that it is difficult to see the wood from the trees. There are some new, perceptive, ideas but it is not clear how the different bits and pieces add up.

The whole, which might have been greater than the sum total of the parts, in fact emerges as less than the sum total of the parts. If we were to think of the speech text as a children's sketchbook, we could try and join the little dots. Alas, that does not add up to a big picture because the dots are too few and too sparse. It seems to me that in charting the path to transforming India, the finance minister hopes to make a giant leap with baby steps.

> Budget's objective should have been growth, employment stimulation via more public investment

Second, the essential theme that runs through the speech is the concern of the government for the well-being of the poor, or the excluded, who do not have a voice in the economy. This is reflected in the repeated mention of agriculture and the rural sector, which is home to a large proportion of our population, or farmers and poor people, who do not have access to opportunities in terms of employment, housing, education, health care, electrification, drinking water or sanitation facilities. Alas, the resources allocated are not directly proportional to these mentions. More important, perhaps, the institutional mechanisms that transform outlays into outcomes are often missing and will have to be created. And it is not clear to me how this "left turn" in politics will sit with the belief in the magic of markets among the influential in government and outside who want a "right turn" in economics.

Third, this budget is more about politics than about economics, in terms of both symbols and signals. The crop insurance for farmers, health insurance for the poor, LPG connections for women in poor households, or electricity for all villages are symbolic in politics. The Gram Sadak Yojana, the long-term irrigation fund, resources for water management, direct grants-in-aid to gram panchayats and municipalities, or the spotlight on the Mahatma Gandhi National Rural Employment Guarantee Act are signals in politics. So is the idea of taxing the rich to help the poor. The Swachh Bharat and Krishi Kalyan cess on service tax, together with the Infrastructure cess on cars, are examples. The tax on dividend incomes above ₹10 lakh per annum, the surcharge of 15% on incomes above ₹1 crore per annum (the super-rich whose total number is reported to be less than 45,000 in India!), or the higher excise duties on expensive jewellery and branded garments, are also symbols in politics. There are income tax concessions—raised ceiling for tax rebate, higher deduction for house rent paid, and raised turnover limits in presumptive taxation for small-and-medium-enterprises—all of which cater to the interests of the traditional political constituency of the Bharatiya Janata Party (BJP). It is almost an election budget. I am puzzled it has come in 2016 instead of waiting until 2018. The reason could be expected time lags between announcement and implementation.

In the minutiae, there are some positives and some negatives. Drawing up a complete balance sheet would take too long.

Some positives are: the attention to agriculture and the rural sector; financial devolution to gram panchayats and municipalities; resources for irrigation, water management and the Gram Sadak Yojana; large allocations for road construction; crop insurance for farmers; health insurance for the poor. There are some minor positives too. For one, the distinction between plan and non-plan expenditure has been done away with, and will be replaced by the more logical distinction between capital and revenue expenditure. For another, there will be a review of the Fiscal Responsibility and Budget Management Act, which represents cognition of its limitations.

Some conspicuous negatives are: too little for education and health; almost nothing for the manufacturing sector despite the rhetoric about Make in India; words rather than deeds for employment creation; using indirect taxes to mobilize additional resources, using cesses and surcharges instead of taxes; announcing yet another tax amnesty in the guise of a compliance window.

For me, however, the biggest failure of this budget lies in the macroeconomic sphere, lost sight of in the bits and pieces. It ignored a rare window of opportunity, opened up by the collapse in commodity prices (particularly crude oil) in the world and low inflation at home, to drive economic growth and foster employment creation that would provide incomes and livelihoods for people. Given the global slowdown, it is only domestic demand, for investment and consumption, which can boost growth.

In this quest, the size of our market, in terms of population if not income, is the biggest asset. This was feasible with two approaches that should have been seen as complements rather than substitutes. The first was fiscal expansion rather fiscal consolidation. For this, it was necessary to breach the Lakshman Rekha for the fiscal deficit at 3.5% of GDP. The second was additional resource mobilization through taxation, which could have increased degrees of freedom for the government. For this, it was essential to tax the taxable given that our tax-GDP ratio is among the lowest in emerging markets. Both approaches needed political courage of conviction.

On the fiscal deficit, the finance minister recognised his dilemma but chose the path of fiscal conservatism, which he described as prudence. This decision has been widely welcomed by observers, analysts and the media. Essentially, it caters to the sentiment of financial markets and credit-rating agencies. But it is not sensible macroeconomics.

The object of the budget should have been to stimulate economic growth and employment creation, through higher public investment in infrastructure, which would stimulate private investment, and higher capital expenditure in social sectors, which would contribute to the well-being of people.

Economists who stress the virtues of macroeconomic stability need to learn that stability and growth are not an either-or choice. What we need is stability with growth. Unlike economists, however, politicians are accountable. In our vibrant democracy, people assess performance of the government in terms of outcomes in development that affect their lives. What matters most is employment possibilities and income levels.

In sum, my concerns about the Union budget for 2016-17 relate not so much to what has been said and done but far more to what remains unsaid or remains undone.

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