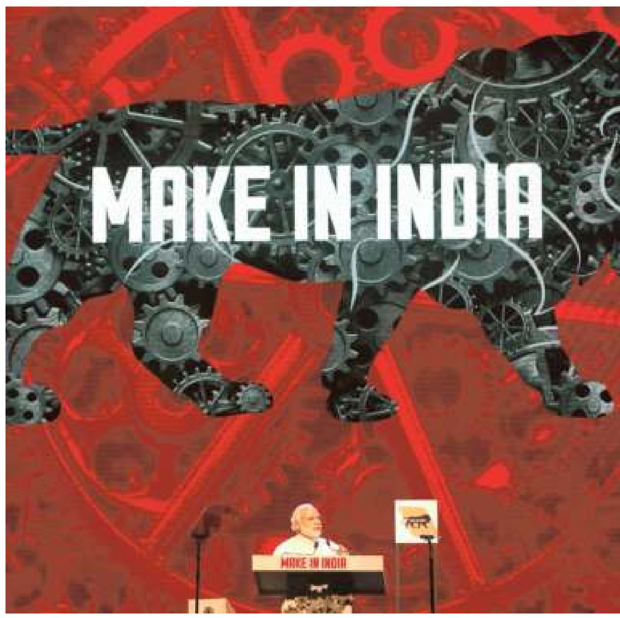
Searching for reform signals

While the Budget shows commitment to fiscal consolidation, there are very few measures that can steer the economy to acceleration

M. GOVINDA RAO

There were high expectations from the Budget to provide a clear road map for much-needed reforms, given that the government received an unprecedented electoral mandate. The GDP growth in the last quarter of 2018-19 was the slowest in the last five years, and considering that the capacity utilisation in manufacturing has already peaked, reviving the investment climate is critical to accelerate economic growth. The unemployment rate, which is 6.1%, is the highest in four decades. With the Economic Survey making a pitch for creating a virtuous cycle of saving and investment, there was hope that there would be far-reaching announcements in the Budget.



Balancing the books

To be fair, Finance Minister Nirmala Sitharaman has a difficult job of balancing the books, particularly when the revenues are not buoyant and demands for expenditure are high. From that perspective, it is noteworthy that she has tried to show her commitment to the process of fiscal consolidation by keeping the fiscal deficit budgeted at 3.3%. The difference between the 3.4% budgeted in the interim Budget and this is mainly due to higher GDP estimates (₹93,168 crore) used in the denominator. The revenue is lower by ₹55,463 crore compared to the interim Budget estimate but this is offset by non-tax revenue estimated to be higher by ₹40,532 crore. Thus, there are not many significant departures from the estimates of revenue and expenditure presented in the interim Budget. The gross income tax revenue is estimated to be lower than the interim Budget by ₹90,000 crore, mainly on account of lower GST (₹97,857 crore) and individual income tax (₹51,000 crore). Despite taking lower estimates, the revenue estimates look far too optimistic in comparison with the pre-actuals given by the Controller General of Accounts. To realise the Budget estimates, the increase over the actual tax collected in 2018-19 in gross tax revenue will have to be 21.2%, net tax revenue must rise by 25.3%, and the non-tax revenue will have to increase by 27.2%.

A major source of additional revenue projected in the Budget is by having an active disinvestment policy. Disinvestment is expected to generate ₹1,05,000 crore, which is almost ₹15,000 crore higher than what was taken in the interim Budget. The Budget speech also speaks about an active disinvestment policy beginning with Air India. Hopefully, the environment will help to implement this. Another source of revenue which is expected to increase is the dividend. This amounts to ₹1,63,528 crore, which is ₹21,457 crore more than what was estimated in the interim Budget. Much of this will be from the Reserve Bank of India (RBI).

The most important reform measure in the Budget is the proposal to streamline multiple labour laws into a set of four labour codes. Although the details are not yet available, it is hoped that the government will embark on the much-needed reforms in this area. This is a contentious issue that has been long debated. The Economic Survey too has referred to the need to make the factor markets less distorting and the disincentives these laws create in ensuring optimal sizes. Hopefully, the government will address this in the interest of increasing employment and exports of labour-intensive goods.

The reform front

On the reform front, while much was expected, the Budget has been clearly disappointing. There are very few measures that can steer the economy to acceleration, leave alone changing gear to achieve the aspirational goal of achieving 8% growth to reach a $5 trillion economy by 2024. On the contrary, some of the measures take us back to the pre-reform era. Over the last three years, there has been a steady increase in import tariff in the name of 'Make in India', and with the U.S. coming hard on India by terminating India's designation as a beneficiary developing nation under the key Generalised System of Preferences programme, it was hoped that there would be an attempt at lowering and reducing the expansion of the protectionist wall. The objective of 'Make in India' should be to make the economy competitive and not to dish out higher cost, inferior products to domestic consumers. By selective increases in customs duty and by varying the rates based on whether the item is an intermediate good, capital good and final consumer good, the Budget has caused the effective rate of protection on many items to be much higher than the nominal rates. This can create unintended distortions. This is clearly retrograde.

> **The Budget allocates ₹70,000 crore for the recapitalisation of public sector banks, but is silent on structural reforms including governance reforms.**

One of the major initiatives needed at the present juncture is to reform the banking system. The Budget allocates ₹70,000 crore for the recapitalisation of public sector banks, but is silent on the urgently needed structural reforms including governance reforms. Nor are there any concrete measures to deal with the Non-Banking Financial Companies crisis apart from empowering the RBI to undertake the regulatory function. Not that everything has to be done in the Budget, but events have shown that there is a need to improve both the legal framework and governance system. Consolidation of public sector banks cannot serve the purpose of changing the structure of incentives and accountability.

Revive the investment climate

The revival of the economy requires the revival of the investment climate. A recent OECD study has shown that corporate taxes in India are very high amounting to almost 48% when the dividend distribution tax and surcharges are taken account of. The Budget in 2015-16 promised to bring the basic rate down to 25%. This was implemented for companies with a ₹250 crore turnover in the 2018 Budget; the present Budget increases it to ₹400 crore. Although these companies cover 90% of the number of companies, their tax payment is less than 10-15%. If large investments have to be attracted, then the reduction should have been general and the scaffolding approach can only disincentivise the companies to grow bigger and better. This only discourages the companies from becoming larger. While the Economic Survey is eloquent about the need to transform the 'dwarfs into giants', the various measures taken in the Budget to incentivise the MSMEs amount to reiterating that 'small is beautiful'.

Cooperative federalism

The Finance Minister speaks about the rejuvenated Centre-State dynamic and commitment to cooperative federalism shown by the government during the last five years. At the same time, most of the measures taken to raise additional revenues are by way of cesses and surcharges. The increase in income tax for people with more than ₹2 crore and ₹5 crore is by way of additional surcharge. Similar is the case with additional tax on petrol and diesel. This is clearly to exclude the additional revenue raised from the divisible pool and deny the share of the tax to the States. Hopefully, the Finance Commission which is deliberating on the devolution will take note of the issue. On any case, such measures do not promote cooperative federalism.

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A Budget that goes nowhere

It would seem that since the government is unable to catalyse domestic investment or fund public investment, it is now turning abroad to fuel growth

C. RAMMANOHAR REDDY

Union Finance Minister Nirmala Sitharaman is mistaken if she thinks her first Budget is going to revive a slowing economy.

The economy grew by just 5.8% in real terms in the last quarter of 2018-19. Yet, the Union Budget for 2019-20 assumes that the economy will grow this year by 12% in nominal terms, or by 7-8% in real terms. How can that dramatic a turnaround take place? Only if there is a sharp pick-up in investment – private and/or public.

There is little in the Budget that is likely to boost domestic private investment. There are neither any incentives for private investment nor support for public investment. To make matters worse, the Budget has actually projected a decline in central government capital expenditure (public investment) in 2019-20 by 6% in nominal terms. This is perhaps the first ever decline in public investment in the past half century, which, once adjusted for inflation, could measure over 10%. It is no wonder that the Finance Minister, shedding the convention of decades, did not mention any allocations for schemes in her speech and pushed all the numbers to the fine print.

Same direction as before

It would seem that since the government is unable to catalyse domestic investment or fund public investment, it is now turning abroad to fuel growth. Some of the norms for foreign institutional investment (FII) are to be liberalised, so too for foreign portfolio investment (FPI) and ceilings on foreign direct investment (FDI) are to be raised in some sectors. More ominously, the government has now decided to go in for external commercial borrowings to meet part of its borrowing requirements, claiming that India's external debt to GDP ratio is very small. This is very much like what the governments of the 1980s did, which eventually led to the balance of payments crisis of the early 1990s. Why are we again heading in that direction?

Prime Minister Narendra Modi's slogan of a $5 trillion economy by 2024-25 has taken over the discourse on the economy. The Economic Survey gave it considerable importance and now the Union Budget has too. We have forgotten that a larger economy does not necessarily translate into improved well being for all. A larger economy is of value only if in the process it delivers more jobs and better services. It is significant that the word "jobs" found no mention in the Finance Minister's speech.

The approach of the Narendra Modi government in its second term seems much like in the first – focus on a select group of welfare schemes like Ujjwala Yojana, Swachh Bharat, Sowbhagya and Jan Dhan (all of which are believed to have served it well in the 2019 elections) and now Jal Shakti, while leaving it to private investment or private consumption to deliver economic growth.

If private investment does not deliver, then the assumption is that private consumption will. Indeed, consumption with the help of household debt has been driving growth in recent years. The dangers of consumption loaded by private debt are obvious.

Numbers from interim Budget

Since the numbers in the Budget papers have steadily lost their integrity, it seems pointless to examine them in much detail. Last month, the Controller General of Accounts had made public the provisional numbers for 2018-19. These showed that central tax revenues were lower than the revised (yes, revised and not Budget) estimates by as much as ₹1.67 trillion. In order to hold down the fiscal deficit, the government cut its expenditure by ₹1.33 trillion. Though these updated figures are available (with the Finance Secretary himself saying in the post Budget press conference that the actuals for 2018-19 are now with the government), why on earth do the Budget papers reproduce the numbers from the interim Budget of February 2019? Obviously because presenting the final numbers for 2018-19 now would have shown the Modi government in a poor light: unable to fulfil its promises on tax collection and spending commitments in its last year of its first five-year term.

To be fair to the Finance Minister, the revenue projections, especially in income tax, are more modest and therefore perhaps more realistic than that of her predecessor. They are modest enough to project a decline in gross tax receipts from 11.9% of GDP (2018-19) to 11.7% of GDP (2019-20), arising from a slump in both direct and indirect taxes. It is interesting that the last time there was a fall in tax revenue was in 2014-15, the first year of the first Modi government.

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How then is the government planning to marginally lower its fiscal deficit in 2019-20 to 3.3% of GDP (assuming that this is indeed a reliable estimate)? It turns out a boost in non-tax revenue will make the difference. The biggest jump is of dividends from the Reserve Bank of India and the nationalised banks: ₹1.06 trillion, a 43% jump over 2018-19. Since few public sector banks are making money, most of this must be expected from the RBI. These dividends have more than doubled from 2017-18. We now know why the government-RBI tussle was so bitter last year.

Cooperative federalism?

True to form, the government swears by cooperative federalism in words but does actually the opposite in practice. A major source of revenue mobilisation is to come from a higher cess and special additional excise duty on petrol/diesel. That is good for the Centre because cesses are not to be shared with the States!

With the year ahead already threatening to be a difficult one because of a monsoon that increasingly looks likely to be less than normal, we have to buckle up. We will not get any support from the second Modi government's first Budget.

A feel good spirit from an impressive electoral victory and slogans about a $5 trillion economy are by themselves not going to give any buoyancy to the economy.

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The macro does not gel with the micro

The Budget describes with admirable practicality what we would like to see in India, but it is not convincing on how we can have the growth to afford the same

PULAPRE BALAKRISHNAN

The maiden Budget presented by Finance Minister Nirmala Sitharaman was much looked forward to partly because she is the first woman to hold this post full time, an achievement for our democracy.

Attention to detail

Though her speech was perhaps a little combative, as she kept asserting the achievements of the first Narendra Modi government, it was nevertheless marked by an even-handedness and attention to detail that is rare. The first was seen in the methodical way in which she ranged over the areas – manufacturing, Gramin India, Shahari India, women, and the youth. One of the many instances in which the second was evident is in the elaboration of the proposed elimination of human interface in the conduct of scrutiny for taxpayers.

However, there was a disconnect in the speech. At the outset, Ms. Sitharaman appeared to assert that India is headed towards becoming a $5 trillion economy by 2024. However, much of the rest of her speech was concerned with what this economy would look like – there would be widely dispersed social and physical infrastructure; a low-carbon footprint; and housing for all, among other desirable things. We were not told how the country will get there. And getting there is important, for the things that have been promised need to be paid for and there has to be the income for this.

Improving ease of living

If only five points in the Budget are to be highlighted, I would choose bank capitalisation; rural electrification to be completed by 2022; a final push for water and sanitation, making India open defecation free by October 2 this year; encouraging solar power usage; and tax-related changes. Of these, electrification, water and solar power may not require large outlays but they make a big difference to people's lives, a reality ably grasped by the Bharatiya Janata Party (BJP), which portrays its actions in these areas as aimed at improving 'the ease of living'.

The infusion of ₹70,000 crore into public sector banks would be a significant contribution to easing the liquidity situation caused by non-performing assets. It is mentioned that this will be accompanied by governance reforms, though we do not know as yet what form they will take, which alone will determine how significant they will be.

> **There is no mention in the Budget of public investment, stepping up of which would be essential even to stimulate private investment right now.**

The package for the financial sector also includes a time-bound public guarantee to commercial banks that acquire assets of the presently troubled Non-Banking Financial Companies (NBFCs). This should bring some stability to the NBFC sector, instability in which would ruin the lives of hundreds of investors and choke lines of credit outside the banking sector.

In case it is found that the capital infusion is inadequate, the government can always increase it later in the financial year, but to have intervened at this stage of liquidity shortage is statesmanly. The proposals on taxation include changes in both tax liability and administration. The exemption limit on the income tax has been raised but the surcharge has now been increased on those in the highest two tax brackets. There is a balancing act here. Similarly, the upper limit for eligibility for the lowest slab of the corporate tax has been raised from ₹250 crore to ₹400 crore.

This in in line with the demands of India's corporate sector but it may not be what is best for the economy at a time when the government needs as much revenue as it can garner to quicken it.

New era of tax administration

However, the Budget may have initiated a new era with respect to the tax administration. Compliance is to be made easier for the taxpayer. There are to be pre-filled tax returns and less human interaction in the event of tax scrutiny. There will be 'faceless assessment' through the use of an electronic mode. Face-to-face encounters between inspectors and the assessees will be eliminated, with notices sent from a central Income Tax cell. Some similar simplification is to be done in the sphere of the Goods and Services Tax too. The Minister is right to speak of all this as a "paradigm shift" in the functioning of the tax department.

While it is surprising that she equated the ease of paying taxes with the ease of living in India, which must take far more into account, it is the case that individuals have experienced powerlessness when dealing with the tax department.

Where the Budget fails

This Budget's failing is in not setting out the means by which the government is to take the economy to the aspirational $5 trillion level. Barring unforeseen productivity surges, we must assume that investment holds the key. At least the Economic Survey tabled earlier spoke of the importance of investment, even though it somewhat ideologically confined validity to private investment.

The Budget has nothing to say on the matter. Perhaps it is believed that the very return of this government is sufficient to release the 'animal spirits' of private investors. However, this would amount to overlooking the history since 2014. In this period, though there has been macroeconomic stability and much attention has been paid to the ease of doing business, private investment has declined. This points to the limits to confining yourself to the supply side when you are interested in growth, which this government is doing.

Moving to a $5 trillion economy by 2024 would require growing at a rate faster than the average that has been achieved since 2014. There is no mention in the Budget of public investment, stepping up of which would be essential even to stimulate private investment right now. Capital expenditure has been raised by much less than the actual increase in the past year.

One way of seeing this Budget is that it is something good in parts. It describes with admirable practicality what we would like to see in India, from water connections to roads. But it is not convincing on how we can have the growth to afford them. We might say then that the macroeconomics does not gel with the microeconomics.

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