Promise and delivery

Arun Jaitley's Budget will be judged by whether it can bridge the gap

If the Union Budget is construed as an annual tug-of-war between populism and fiscal prudence, arguably it is the latter that prevailed in the past four budgets tabled by the NDA. However, populism seems to have gained an upper hand in Arun Jaitley's latest effort. Despite exceptional buoyancy in direct tax revenues (18.7% growth in FY18) and record disinvestment proceeds (₹1 lakh crore), shortfalls in GST mop-ups and dividend receipts have forced the Finance Minister to ease off on fiscal consolidation as mandated by the FRBM Act. The Budget has reported a fiscal deficit of 3.5% (of GDP) for FY18 and pegged it at a high 3.3% for next year. The Economic Survey prepared the ground for a deviation, yet the actual numbers surprised the markets. Armed with a war chest of ₹24.4 lakh crore in budgeted receipts for FY19, Mr. Jaitley has homed in unerringly on the root causes of distress – unremunerative farm incomes, unemployment, lack of social security nets and the squeeze on the middle-class taxpayer.

With this in mind, Mr. Jaitley has announced a laundry list of ameliorative measures. While his intent is clearly welfarist, resource constraints have forced him to rely significantly on extra-budgetary resources and external agencies to give life to many proposals. If they fail to materialise, it can lead to a gap between promise and delivery. Consider agriculture. After asserting that minimum support prices (MSPs) should cover all crops and assure farmers 1.5 times their production cost, food subsidy allocations for FY19 have been upped by a relatively modest ₹29,041 crore. A 'fool-proof' mechanism has been mooted to avoid market prices falling below MSPs, but it is left to the Niti Aayog to work out the modalities. Setting up farmers' markets is similarly a great idea to free small farmers from the tyranny of Agricultural Produce Market Committees (APMCs), but the project gets a mere ₹2,000-crore allocation.

The ambitious rural package in this Budget brings in free gas connections to three crore new households, free electricity connections to four crore homes, two crore new toilets under the Swachh Bharat Mission, higher micro-irrigation coverage, and so on. But of the massive outlay of ₹14.34 lakh crore required to bankroll these grandiose plans, as much as ₹11.98 lakh crore is expected to be met from extra-budgetary resources. A similar template has been used in social sector schemes. The National Health Protection Scheme, to provide a ₹5 lakh health cover to 10 crore households, is a much-needed social security intervention to benefit poor households that rely overwhelmingly on private health care. But there is little clarity on modalities. The entire clutch of proposals on improving learning outcomes, providing universal health coverage and alleviating the lot of minorities and girl children is expected to be funded through a mere ₹16,000-crore increase in allocations to ₹1.38 lakh crore. Infrastructure appears to be one of the few sectors where the funding problem has been addressed, with PSUs bankrolling a significant proportion of the ₹5.97-lakh crore outlay for FY19.

While being liberal in its announcements for rural India, the Budget has been frugal in its giveaways to the middle class and the corporate sector. Expectations of an increase in the basic exemption limit on income tax have been belied; instead, a standard deduction of ₹40,000 is back for salaried taxpayers. While it is only fair that the salaried pay income tax on their net income (after expenses) as the self-employed do, this deduction (which also replaces transport and medical reimbursements) is too small to establish real parity. The clamour for an across-the-board cut in the basic corporate tax rate from 30 to 25% has also been ignored, with the cut limited to mid-size companies (up to ₹250-crore turnover). Though this will benefit the overwhelming majority of corporate tax filers, how this impacts the competitive edge of India's largest companies in the global context will be debated. Especially so, since the U.S. recently slashed its corporate tax rate to 21% and European nations average 20%. For the salariat and the corporate sector, the increase in education cess will offset some of the gains from these tax cuts. Senior citizens have benefited, particularly from the tax relief on interest from bank deposits and post office schemes, which has been hiked from ₹10,000 to ₹50,000 a year. These interest payouts are also exempt from the vexatious TDS provisions. This relief renders senior citizens far less vulnerable to steadily dwindling interest rates on bank deposits and small savings schemes; it also helps them to continue relying on fixed-income instruments to cover living expenses. This relief may reverse the unhealthy trend of risk-averse savers shifting wholesale from bank deposits to market-linked options such as equity mutual funds, in search of higher returns.

The imposition of 10% long-term capital gains tax on profits from shares and equity mutual funds could dampen market sentiment in the near term, but is unlikely to have any structural impact on domestic equity flows. Equities are favoured by the relatively affluent savers and alternative financial instruments such as bonds and fixed deposits invite far higher tax incidence. Moreover, the bulk of new allocations flowing into Indian equities in the last two years have come from retail investors, most of them saving for the long term. It is unlikely that they will beat a hasty retreat from shares or mutual funds just because of a modest levy. Overall, the Budget has a sense of direction that is difficult to find fault with. If some of the proposals seem half-hearted or are not taken to their logical end, it may be the result of revenue constraints. It is to be hoped that as the revenue base improves and GST collections stabilise, future budgets can put the finishing touches on the welfare proposals.

Goodbye to fiscal consolidation

With the rural constituency in focus, the government's spending road map may cross expected limits

T.T. RAM MOHAN

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The Narendra Modi government has taken pride in having restored the economy to the path of fiscal consolidation. The fiscal deficit target for 2017-18 had been set at 3.2% of GDP for 2017-18 and 3.0% for 2018-19. The Budget for 2018-19 puts paid to these objectives for now. The fiscal deficit for 2017-18 has ended up at 3.5%. For 2018-19, the government has set a target of 3.3%. The fiscal deficit target of 3% of GDP has now been pushed to 2020-21.

Missed targets

Revenue receipts in 2017-18 have grown faster than anticipated (although non-tax revenues have fallen short of target). We can compare the revised estimate for 2017-18 with the actual for 2016-17 and the Budget estimate for 2017-18 with the revised estimate for 2016-17. Tax revenues were higher than anticipated (15% compared to 13%).

Capital receipts are expected to exceed the budgetary estimate thanks to record disinvestment revenues of ₹100,000 crore (₹27,500 crore higher than targeted). On the revenue side, the government could not have expected better.

It is the expenditure side that has given way. Revenue expenditure grew by 15% compared to the Budget estimate of 6%. An increase in establishment expenditure accounts for more than 40% of the increase in revenue expenditure. Capital expenditure ended up lower than in the previous year by 3.9%. In the Budget for 2017-18, capital expenditure had been set 10.7% higher. This was flagged as one of the great accomplishments of last year's Budget and it was expected to boost GDP growth.

The fiscal slippage in 2017-18, therefore, cannot be ascribed to a lower than projected nominal growth (around 9.5% compared to 11.5%). Expenditure has got out of control or was under-estimated in last year's Budget. Moreover, revenue, not capital, expenditure is the villain. The revenue deficit for 2017-18 is 2.6% of GDP, way above the Budget estimate of 1.9% of GDP.

Projections for new fiscal

What do we make of the projections for 2018-19? The Budget projects an increase in tax revenues of 16.6% compared to 15.3% in the previous year, which appears achievable. Total expenditure is expected to grow by 10.1% compared to 12.3%, which could turn out to be an under estimate. Capital expenditure has been set 9.9% higher which is modest given that there had been a decline in the previous year.

Growth in public investment is tepid. There are no big tax giveaways either in the Budget. Clearly, fiscal policy is not being used to stimulate growth. With inflation running at 5%, the scope for monetary easing too is limited. The government is leaving it to market forces to drive growth in the coming year.

Will it work? In 2017-18, the Economic Survey argues, growth was dampened by a combination of factors: high real interest rates, disruption caused by demonetisation and the goods and services tax (GST), the twin balance sheet problem and high oil prices. The disruption caused by demonetisation and GST is out of the way. The Survey hopes that the bankruptcy process put in place will resolve the twin balance sheet problem – we have to see how the process plays out. As inflation edges up, we could see monetary tightening. With oil prices projected to be $10-$12 higher in the coming year, growth could be adversely impacted by 0.3%.

One source of anxiety is overheated asset markets the world over. In India too, equity valuations have been extremely stretched. The Budget has introduced a tax of 10% on long-term capital gains while retaining the securities transactions tax. The reaction of the market thus far has been muted.

However, should asset prices fall elsewhere, we could see the same happening here. Consumption and investment would fall as a result. The monetary authorities may have to raise interest rates in order to stem capital outflows. In such a situation, fiscal expansion would be required to sustain growth. This would clearly upset the budgetary arithmetic. The budgetary projections for 2018-19 thus hinge critically on nothing going wrong with the equity markets and investors shrugging off the tax on long-term capital gains.

On the positive side, the ratio of gross tax revenues to GDP, which had been stagnating at around 10% since 2008, has risen to 11.6% in 2017-18 and is projected to rise further to 12.1% in 2018-19, 12.4% in 2019-20 and 12.7% in 2020-21. This shows that demonetisation and GST are beginning to pay off by widening the tax base and increasing the buoyancy of tax revenues. There is reason to be optimistic, therefore, about the medium-term outlook for government finances whatever the problems in the next year or two.

Rural foray

Many analysts had expected a populist budget in the run-up to elections. Typically, this meant tax concessions to the salaried classes and measures such as loan waivers. These are absent in Finance Minister Arun Jaitley's Budget. The Budget brings back the standard deduction for tax payers, of ₹40,000. But this is in lieu of transport and medical expenses and is also offset partially by an increase in cess from 3% to 4%. There is little else to cheer for the middle class.

However, the Budget has tried to reach out to the rural constituency and to the poor through a number of measures. The most notable, perhaps, is the promise of a minimum support price (MSP) for all crops of 50% above the cost of production. Rural distress is pervasive and the fall in the price of groundnut, for example, in Saurashtra appears to have cost the Bharatiya Janata Party (BJP) dearly in the Gujarat elections. The proposal on MSPs is thus shrewdly timed, though it would mean higher prices for consumers.

The Budget proposes a health insurance scheme that will cover 10 crore poor families with an insurance cover of ₹5 lakh each. Since such a cover would mean an annual premium of at least ₹10,000, it is doubtful that it is backed by actual outlays in the Budget. Moreover, basic health care must be provided through government hospitals and not through insurance that pays for care at private hospitals. This is a disturbing sign that we are going down the American route to health care instead of, say, the Canadian route.

The Budget also includes several measures for micro, small and medium enterprises (MSMEs). There is a target of ₹3 lakh crore for lending under the MUDRA scheme. The government will pay 12% towards the Employee Provident Fund for new employees in all sectors for the next three years. A lower corporate tax of 25%, hitherto applicable to enterprises with a turnover of ₹50 crore, is now applicable to companies with a turnover of up to ₹250 crore.

It is clear that a return to a high growth trajectory of 8% is unlikely before the 2019 election. The BJP seems to have reckoned it has the urban middle class with it regardless. It is the rural constituency that needs focus. The Budget for 2018-19 has expenditure items planned accordingly while ensuring that the fiscal deficit stays within reasonable bounds.

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The question of credibility

The entire fiscal adjustment path has been reworked in this Budget

M. GOVINDA RAO

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There were considerable expectations from the Budget. Given that this is the last full-year Budget by this government and the first one after the revenue uncertainties arising from implementation of the goods and services tax (GST) reform, there were apprehensions about the slippages as well. Indeed, there are electoral budget cycles in every democratic polity and considering the dissatisfaction shown by rural electorate in the recent Gujarat elections, there were definite apprehensions about fiscal laxity.

Focus areas

The Finance Minister devoted a considerable part of his speech to elaborate the focus areas in the Budget. These include strengthening the agriculture and rural economy, provision of good healthcare for the poor, taking care of the senior citizens, creation of infrastructure, and working with the States to improve the quality of education. A careful analysis of the allocations to various sectors, however, does not show any significant departures from the past except in the case of allocation to food storage and warehousing which is set to increase by 19.4% due to the assurance of minimum support prices at 150% of the cost. The total expenditure in 2018-19 is estimated to increase by about 10.2% over the revised estimate of the previous year, and the increase in capital expenditure is estimated at 9.9%. In fact, direct spending on social and economic services by the Union government is estimated to increase by only 7.8% and 6.7%, and increase in the grants to States for Central schemes is estimated at 13.8%. Thus, the objectives of improving the wellness of the people, removing the farm distress, improving the quality of education and augmenting infrastructure are supposed to be achieved by using extra-budgetary funds.

The most important worry, however, is on the fiscal front. A close examination shows that there have been substantial slippages in all the deficit numbers. In fact, even for the year 2016-17, the fiscal deficit works out to 3.7% as against 3.5% shown in the Budget if the GDP estimate put out by the Central Statistics Office on January 31 is taken. The revised estimate of revenue deficit in 2017-18 works out to 2.6% as against the Budget estimate of 1.9%, and the slippage in primary deficit is from 0.14% to 0.38%. Much of this has happened not because of revenue shortfall or increase in capital expenditure. In fact, despite shortfall in indirect taxes, the tax revenue net of devolution to the States shows an increase of 3.4% over the Budget estimates. Similarly, even as non-tax revenues realisation was less due to the inability to generate spectrum fees and lower dividends from the banks, total revenues available with the government was higher than the Budget estimate by over 3%. The slippage happened even as capital expenditure was compressed by 12% due to a sharp increase in revenue expenditure. The capital expenditure in 2017-18, as also that budgeted for 2018-19, at 1.6% of GDP is perhaps the lowest since 2014-15. Thus, the slippage was mainly on account of higher than budgeted spending in revenue expenditure, particularly the grants given to the States for Central schemes, which was higher by 25.8%.

The Economic Survey had emphasised the need for ensuring macroeconomic stability in view of both domestic and global developments and in this the importance of fiscal discipline is stated to be paramount. However, this Budget has reworked the entire adjustment path. The estimated fiscal deficit for 2018-19 is 3.3%, and in addition, the government will issue bank recapitalisation bonds amounting to ₹80,000 crore. Proper accounting demands that this should be a part of the fiscal deficit as when the shares of public enterprises are sold, these are taken as non-debt capital receipts, but when the bonds are purchased by the government, they are not counted for the deficit! The Finance Minister states that he accepts the key recommendations of the FRBM Committee to bring down the debt-to-GDP ratio to 40% and the fiscal deficit target will be the key operational parameter, but does not adhere to the 3% target for the next year and 2.5% for the subsequent years set by the Committee! The medium-term fiscal plan states that the 3% target will be reached only in 2020-21. Fiscal management in the country suffers from credibility crisis.

On the taxes front, the most important issue is the proposal to levy the long-term capital gains tax above ₹1 lakh at the rate of 10% for instruments bought after January 31, 2018. Those who advocated the levy were clear that the tax policy should not affect the investors' choice of financial instruments, which meant that the treatment should be uniform for equity and debt-based instruments. This would require uniform application of the tax to all instruments and the abolition of securities and commodities transaction taxes. There is a case for the tax to be neutral between all forms of investments including immobile properties. In that sense, what has been attempted is a half-way house.

Too loaded

Furthermore, when the reform required that the tax policy should not be loaded with many objectives, the Budget goes on to use the instrument to promote post-harvest activities in agriculture, employment generation and incentivising micro, small and medium enterprises. On indirect taxes, increase in custom duties to facilitate "Make in India" is a retrograde measure. We have been advocating moving away from protectionism in global forums, but want to protect the domestic producers through higher import duties. This may make some producers happy, but will not increase the competitiveness.

M. Govinda Rao, who was a Member of the Fourteenth Finance Commission, is Emeritus Professor at the National Institute of Public Finance and Policy

LETTERS TO THE EDITOR

Letters emailed to letters@thehindu.co.in must carry the full postal address and the full name or the name with initials.

Many questions

This year's Budget is an anticlimax. Along with the usual assortment we have come to expect every years is the Finance Minister's claim that we are on course to reach a growth rate of 8%. This is actually 6% on the "old scale". The government does not seem to have used the bounty of low crude prices in the first three years and world trade being on the mend. We should actually be looking at a rate of 10-12% now. Several announcements only raise questions about their means of funding, thanks to the state of the economy these past months. It is time we realised that we should be done with hype and bluster.

M. Balakrishnan,
Bengaluru

Rohingya crisis

The Rohingya are at a juncture where not taking timely action to save them might result in a mess of colossal magnitude. Such issues cannot be dealt with single-handedly. India and Bangladesh are facing great pressure handling the many thousands of refugees especially as they lack the necessary infrastructure to accommodate a growing number of refugees. In the Rohingya crisis, India faces a predicament: it cannot turn them away for they will walk into the jaws of death; if accommodated, they will live in abject poverty and squalor, the consequences of which do not bode well for India. Myanmar must be told in no uncertain terms that it has to take responsibility for its own citizens ("India can't be refugee capital", February 1).

Vrinda Rajvanshi,
New Delhi

Still blue

The decision to continue issuing "blue passports" for all Indians after withdrawing the plan on "orange passports" for Indian migrant labourers is welcome. When no less than the Prime Minister talks about 'one tax, one nation, one election', it was strange how the idea of having passports in two categories was even thought of ("Facing criticism, govt. backs down on orange passports", January 31). Such plans that are bound to create controversy need to be analysed in advance. Migrant labourers contribute their mite in other ways and discriminating against them in the form of a different passport would have been unwise.

A.J. Rangarajan,
Chennai

'Pakoda' politics

If I remember right, it was P. Chidambaram, when Finance Minister, who extolled the virtues of self-employment. He must be aware that those who are self-employed serve the cause of the nation by not seeking employment outside, and also providing jobs to others, thereby contributing to the nation's economy in their own way. If *pakoda* selling is not self-employment, what else is? Is only being employed in a McDonald's or KFC outlet deemed righteous employment? Mr. Chidambaram must also be aware that some of the unlettered, self-employed men in our country earn far more than formally employed, highly qualified men. It was also during Mr. Chidambaram's tenure that the 'Saral' form was introduced as a part of filing IT returns to bring those who are self-employed under the IT net ("Chidambaram, BJP in war of words", January 29).

Sivamani Vasudevan,
Chennai

■ A *pakoda* seller makes his own living using his entrepreneurial skills and taking calculated risks. His survival depends on so many factors specific to the product. He is also, in several instances, the breadwinner in his family and possibly an employer for many. He is symbolic of free-spirited Indian youth who try not to be a burden to society, but contribute to it by providing employment instead. The former Finance Minister's idea of "employment" is perhaps linked to the idea prevalent under British rule, when only holding a government job qualified as being "settled". In today's world, those such as the humble *pakoda* seller are a vital conduit for the free flow of corruption-free resources from the bottom to the top of the hierarchy.

Shrikanth Kolathaya,
Puttur, Karnataka

■ Mr. Chidambaram has raised a valid question of job security in selling *pakodas* for a reasonable and secured standard of living for all. No doubt the BJP government has been reiterating the point that lakhs of jobs will be created during its five-year term, but it appears to be a mirage. There needs to be data on jobs created which will help us analyse the efforts being made to create employment. Enough of the rhetoric.

R. Rangarajan,
Secunderabad

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