Business Standard

Ajay Shah: A conservative Budget

But, given the economic slump, it comes up short

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Economic conditions in India have been difficult from 2012 onwards. We have slow output growth, weak investment and a balance sheet crisis in many corporations and most banks. The full impact of demonetisation is as yet unknown. The demonetisation episode exacerbated the reputation of inadequate economic policy capacity. We are relieved at the Budget announcements in that there are no odd ideas. The deeper problems of the economy and of the reforms process remain.

The Indian economy got into trouble in 2012. In the preceding decade, projects under implementation (as measured by the CMIE Capex database) had grown six-fold to reach a level of Rs 100 lakh crore. In 2017, i.e. five years later, we are stuck at the same value. This is a striking contrast: A decade in which the projects under implementation grew by six times, followed by five years in which they were stalled. The challenge of economic reforms is to get investment and growth moving again.

Matters have become more difficult owing to demonetisation. This has a direct impact upon output from November 2016 to March 2017. It has harmed many firms, who will now be less likely to invest. It has hurt the reputation of the Indian policy establishment.

Private persons (in India and abroad) used to think the Indian state was a little incompetent and a little socialist, but had a bedrock of technically sound economic policy. It was felt that many odd ideas float around, but there is an economic policy establishment which will be able to shoot them down, while slowly making progress on the main strategy for reforms. I remember how, in the early 2000s, the Department of Economic Affairs had more economics firepower than any other place in India.

The economic policy establishment has, however, been losing strategic and operational capability. With the problems of Vodafone, Mauritius, the 2013 currency defence and now demonetisation, economic policy has become more erratic. This hampers investment. Expectations were low in the run-up to the Budget. There were concerns about more erratic behaviour, ranging from intensification of the war on cash to the new fad of “Universal Basic Income”. We are all relieved that these expectations were proved wrong. The Budget announcements are reasonably low-key and workmanlike.

Illustration by Binay Sinha

Revenue receipts are projected to go down from 9.44 to nine per cent of GDP. Total expenditure is projected to go down from 13.36 to 12.74 per cent of GDP. The fiscal deficit is projected to go down from 3.54 to 3.24 per cent of GDP. This is cautious, sound work.

This happy picture is marred by concerns about estimates. There are grounds for concern about the GDP and revenue projections. The Jan-Feb-Mar 2016 quarter is critical to finances for 2016-17, and in this quarter, it is likely that tax revenues will be impacted by demonetisation. Demonetisation will exert an overhang on 2017-18 GDP growth, and inflation is likely to be weak, which raises concerns about the nominal GDP growth projection of 11.75 per cent. However, even if the actual values prove to be worse than those shown in the Budget calculations, it remains a reasonably conservative Budget.

While a reasonably conservative Budget is a good outcome when measured against expectations of erratic outcomes, it is not good enough to solve the problems of the economy. How do we get India moving again? The work of the ministry of finance is to engage in fiscal, financial and monetary reforms. It consists of building impersonal institutional machinery that delivers consistent sound outcomes.

As an example, three good things in terms of fiscal institution building were pointed out in the Budget speech: Advancing the date to February 1, ending the concept of Plan expenditure, and ending the Railway Budget. These are the kinds of things that build institutional capacity, that help us get better answers for a large number of small decisions such as the capital allocation for railways.

We have serious problems in tax policy and tax administration. We are making little progress on building sound tax administration. On tax policy, direct tax reform is embedded in the Direct Tax Code, which is stalled. The goods and services tax (GST) is a project that is moving, but in a different direction from what is required. A sound GST is a low single rate with a comprehensive base and a single administration. This is unlikely to materialise. The announcements for 2017-18 do not inspire confidence on tax reform.

In the field of finance, the reforms process is about getting to the Indian Financial Code. The Budget speech announcements carry through some elements of work such as the Resolution Corporation which have been in the pipeline. But there is no work plan for the coming year. This is cause for concern.

The Indian fiscal system badly requires deeper reform of the Budget process. Most expenditure programmes work badly, delivering low bang for the buck. There is little progress on addressing these difficulties.

Economic policy is about strategy and then about operations. Halfway into the life of this government, there are concerns about both. Projects such as the Insolvency and Bankruptcy Code were sound on strategy and weak on operational capability. In many other areas, there is a lack of strategy.

India was in a deep recession from 1998 onwards. How did we get out of that? Optimism changed when the private sector saw a series of areas where there was sound strategy and sound operations: Telecom, equity market, highways, ports, tax policy, etc. In each of these fields, there were strong teams with support from the political leadership who were able to bring high intellectualism into establishing a strategy, and then carry projects all the way to delivery. This is the scale of the challenge that we face today, in climbing out of our economic slump. This is the yardstick against which the Budget speech should be measured, and it comes up short.

The writer is a professor at the National Institute of Public Finance and Policy, New Delhi