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Rathin Roy: Prudent in practice, extravagant in rhetoric

Govt is aware that nominal growth is going to be much lower than projected

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The government of India has an appalling track record in keeping its promises on fiscal prudence. Hence, this is what I focus on first when the Budget is announced. Last year, I was delighted as the government maintained its commitment to stick to the announced fiscal consolidation path. This year, I was pessimistic since there were cries for “expansionary” and “counter-cyclical” fiscal expansion from many quarters. The finance minister did not delight me this year but did not depress me either. He has secured the fiscal deficit/GDP target for FY16 and has slipped to 3.2 per cent in FY17 which is 0.2 per cent higher than the 3.0 per cent promised last year. He has also importantly maintained the decline in the revenue deficit/GDP ratio, outperforming FY16 projections.

As a consequence the Revenue/Fiscal deficit ratio is around 60 per cent for both FY16 and FY17. He has taken cognisance of the report of the FRBM review committee (of which I was a member) and has taken note of the fiscal deficit road map recommended by the committee. He has postponed any implementation of the recommendations of the committee by a year but, in so taking cognisance, established his commitment to continued consolidation.

The 0.3 per cent of GDP decrease in the fiscal deficit happens by shrinking both the revenue and the expenditure shares of the central government in GDP. I am in agreement with this approach, as I have argued that the solution to our present economic woes is not a mindless expansion in the size of central government. Thus, revenue receipts are projected to fall from 9.44 per cent of GDP in FY16 to 8.99 per cent in FY17 and total expenditures from 13.36 per cent to 12.74 per cent of GDP. This latter fall is entirely on revenue account with expenditure on capital account staying almost constant at about 1.84 per cent of GDP. Make no mistake, with both tax revenues and fiscal deficit projected to fall as a percentage of GDP, this arithmetically means a smaller central government. My minority view is that this is a good thing, as I have little confidence in the quality, efficacy or effectiveness of central government expenditure and I am happy that those in charge concur with my view.

I am therefore amused at the grandiose claims being made about increased spending on many fronts, both in the Budget speech, and by commentators. There is little expansion in spending. To see this, remember that nominal growth is projected at 11.75 per cent of GDP in FY17. Expenditure on agriculture grows by 6 per cent, education by 8.3 per cent, and defence by 5.8 per cent, all much less than the GDP growth. Petroleum subsidies will actually decline by 9.2 per cent. It is only transport and rural development outlays that grow by 20.1 and 11.8 per cent, respectively. This is by no means an expansionary fiscal policy.

The Budget speech asserts that India's tax-GDP ratio is low, direct tax collection incommensurate with income and consumption, and tax evasion rampant. It is optimistic about future tax collections due to demonetisation. For this optimism to be justified one would expect the tax-GDP ratio to rise appreciably. But this is not the case. While the tax-GDP ratio in the revised estimates for FY16 is clearly much better than anticipated in the Budget estimates (and here again, the rise in the ratio is due solely to the increase in indirect taxes), there is no great increase in the tax-GDP ratio projected for FY17. It is projected to rise by just 0.06 per cent of GDP. The corporate income tax and excise ratios are projected to fall, service tax and customs collections to remain constant, and only taxes on personal income are expected to rise (all as a proportion of GDP). So unless it is the government's contention that things would have been much worse given the anticipated growth slowdown (which means, in turn, that the assumed 11.75 per cent growth is a gross overestimate), the optimism on this count in the Budget speech is not borne out by the arithmetic presented.

So my reading of the Budget is —this is a prudent Budget that is trying to bring feel-good by rhetoric, rather than by profligacy, which is an excellent idea. The government is aware that nominal growth is going to be much lower than projected and has made provisions by being cautious about its tax and expenditure projections. It has taken some fiscal headroom to allow for lower growth in FY17 and for this reason has also postponed the implementation of a new FRBM Act by a year while committing to some of the numerical recommendations.

My big disappointment is the return of bad old habits. Part B of last year's Budget was all about tax reforms. This year, the word is entirely absent from the table of contents. Instead, Part B is back to being a chartered accountant's paradise, replete with schemes and exemptions and a section on transparency in electoral funding which, while laudable, is largely irrelevant to revenue policy. Unlike last year, this year's Budget contains worrying provisions, (specifically, Paras 2.7 and 2.28-2.37 of Annexe III of the Budget speech) that provide powers to tax collectors that can potentially increase tax terrorism. This return to bad habits of yore may delight the mob but will regress India's progress to a modern tax system.

The writer is director and CEO, National Institute of Public Finance and Policy and was a member of the FRBM Review Committee