Budget 2017

Reforms take a back seat

It has done precious little to rationalise explicit subsidies

The difficult international environment, decelerating economy and hardships suffered by the people on account of demonetisation had raised high expectations of a reform-oriented budget to revitalise the economy to accelerate growth and employment opportunities. The international environment marked with growing protectionism will continue to constrain the exports. As the US is set to raise interest rates, the net capital outflow is likely to increase, exerting pressure on the exchange rate. The possibility of increase in crude oil prices has the potential to put pressure on domestic prices as well as fiscal and current account balances. On the domestic front, the CSO's estimate shows that even without taking into account the effect of demonetisation, the growth rate of the economy has decelerated to 7.1% from 7.6% in the last year and in fact, every sector of the economy except agriculture and public administration, has decelerated by varying magnitudes. The gross fixed capital formation is estimated to decline from 29% in FY16 to 26% in the current year. The Economic Survey acknowledges the negative impact of demonetisation, but asserts that the slowdown is likely to be limited to 0.25-0.5 percentage point which, considering the disruption in both production and consumption caused by it, seems to be a clear underestimate. The CMIE's estimate of new investment during the last quarter at ₹1.25 trillion was virtually half of the average investments recorded during the nine previous quarters.

The finance minister must be complimented for continuing the process of fiscal consolidation. In fact, he has succeeded in reducing the fiscal deficit in the current year to 3.2% as against the budget estimate of 3.5% and the revenue deficit has been contained at 2.1% as compared to the budget estimate of 2.3%. For FY18, the fiscal deficit is budgeted at 3.2% as against the target of 3% set by the FRBM Committee and in the prevailing environment, the marginal slippage should not be grudged. There was a lot of apprehension about Review Committee's recommendations, and the Committee has done well to recommend a continued path of consolidation to reduce the overall debt-GDP ratio to 60% from the present level of 70% and Centre's ratio of 40% from the 47% prevailing at present. In fact, at 3.2% of the GDP, interest payments constitute 35% of the net revenues and only a little less than twice the capital expenditure. Conceptually, it is difficult to measure the optimal debt ,and the consolidated fiscal deficit target set by the 12th Finance Commission of 6% was based on the size of the household sector's financial saving. Importantly, even as the committee recommended relaxation of 0.5% for exceptional exigencies, the finance minister has continued the path of austere fiscal stance, not invoking this clause.

There has been a clamour for initiating the Universal Basic Income (UBI) in this budget. As discussed in the Economic Survey, this is an idea whose time for implementation has not yet come. In particular, this cannot be an additional scheme and requires discontinuing various subsidies and transfers to release the required resources. At the same time, the budget has done precious little to rationalise explicit subsidies which, at ₹2.7 lakh crore, constitute 1.6% of GDP. In fact, subsidies claim as much as what has been allocated to defence and is just a little lower than capital expenditures. Food and fertiliser subsidy alone constitute ₹2.4 lakh crore.

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It is in allocating resources for public investment where the finance minister has been stingy. In a situation where the growth scenario is severely hampered by poor investment climate and gross fixed capital formation the lowest in 20 years, substantial step up in public investment was necessary to revive the investment climate. Increase in public spending on infrastructure would have helped crowd in private investment. In fact, the revised estimate of investment spending in FY17 at 1.8% of GDP was substantially higher than the budgeted (1.6%). However, in FY18, it remains at the same level at 1.8% and the increase is just about 10.7% over the revised estimate. In fact, even within this, the capital expenditure under defence is about 0.5% of GDP, the impact of which will spill over the country through imports. Considering the difficult investment climate the country is in, it would have been desirable to augment capital expenditure to at least 2% of GDP either by reducing the subsidies, which as mentioned earlier constitute 1.6% of GDP or by increasing taxes.

On tax proposals, the picture is mixed. Reduction in the rates of tax for companies with less than ₹50 crore turnovers to 25% from the existing 30% potentially benefits 96% of the companies. At the same time, very little has been done to rationalise tax preferences and reduce the rate to 25% for all corporates by 2019, which was promised by the finance minister in the Budget 2015. On the personal income tax, the reduction in the tax rate to 5% for individuals up to ₹5 lakh income does provide some relief. At the same time, the scope of surcharge has now been expanded to people earning with taxable income of ₹50 lakh to ₹1 crore at 10% in addition and the present surcharge on those earning more than ₹1 crore at 15% will continue. Interestingly, the loss of revenue due to reduction in the tax rate is shared between the Union and states where as the gain from levying the surcharge on incomes accrues only to the Union government!

On indirect taxes, given that GST is scheduled to be rolled out in July, 2017, some rationalisation in excise duty could have helped to make the transition smoother. There are 300 commodities exempt from excise duties and the list could have been pruned. Similarly, there are several rates of tax, some of them specific and these could have been aligned to the rates decided by the GST Council. It would also have been useful to increase the threshold for Service tax to ₹20 lakh, the threshold for GST decided in the Council.

On the whole, the budget is a 'business as usual budget'. The abnormal times required a bolder budget and this is not. We live in the hope that the government will catch much publicised illegal cash deposited in the banks after demonetisation and increase spending on infrastructure during the course of the year.

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