NIPFP Working paper series

Budget 2017-18:

Business as Usual

No. 191
01-Mar-2017
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New Delhi

Budget 2017-18: Business as Usual

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ABSTRACT

Budget 2017-18 was presented at the time when the global situation is inhospitable, marked with protectionism and domestic environment is constrained by the twin balance sheet crisis. The investment climate is further jeopardised by the note ban. There was a great deal of expectations on the budget this year to create a policy environment to kick-start the virtuous investment cycle in the economy. However, this budget has turned out to be a mere 'business as usual' budget. While it does well to be prudent in containing the deficits, it fails to address the critical issue of accelerating investment and employment. The capital expenditure as a ratio of GDP is static and the clean-up of tax preferences, as promised, to reduce the corporate tax rates is yet to be initiated. The Finance Minister has lost the opportunity to prune the exemption list and align the excise duty rates in preparation to the GST implementation. Finally, the measures to reduce cash donations and the introduction of bonds to political parties is cosmetic and is not likely to have any impact on cleaning up political funding as long as anonymity of donors is assured.

Keywords: budget, budget systems, deficit, surplus, forecasts of budget, deficit and debt

JEL Classification codes: H61, H68

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1. INTRODUCTION

The presentation of the Union budget in India, unlike in most other countries, is a big event. The reason for this has to be found in the legacy of planned development strategy in which budget was not merely a Financial Statement required to be placed in the Parliament under Article 112, but became a mechanism to transmit policy directions to the economy. The legacy has continued even as the planning process itself got diluted. From that perspective, excessive focus on the Union budget is somewhat misplaced as policy pronouncements and decisions are taken not just in the budget announcement, but throughout the year. Even from a purely fiscal policy stance, the Union budget in India accounts for only a little more than a half of the deficits, 68 per cent of outstanding debt 60 per cent of taxes collected and 58 per cent of actual spending and the rest are undertaken at the State level. Nevertheless, the Union budget provides important signals on the extent of government interventions in the market, and has implications for both macro and micro economy from its stance on deficits and debt, tax and expenditure proposals and intergovernmental finance.

In many ways, this year's budget had a number of new features. First, the budget presentation has been advanced by a month to complete the process of passing it in the Parliament within the financial year. Second, the merger of Railway budget with the main budget helps to plan and develop the transport sector as a whole. Hopefully, the commercial character of Railways will be retained and eventually, it will be corporatized and the social obligations are taken account of by providing explicit subventions from the consolidated fund. Third, the abolition of Plan and Non-Plan distinction, which in fact was the recommendation of the Expert Group on Efficient Management of Public Expenditures chaired by Rangarajan in 2013, helps to look at each of the sectors in a holistic manner and avoids distortions in allocating resources between maintenance of existing assets and creation of new assets.

The budget this year is presented in difficult international and domestic economic environment. The international environment is marked by growing protectionism, particularly after the US elections and is likely to constrain service sector exports to add to the stagnant commodity exports. As the U.S is set to raise interest rates, the net capital outflow is likely to exert greater pressure on the exchange rate. The possibility of increase in crude oil prices along with the pressure on exchange rate has the potential to affect 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 per cent in the current year from 7.6 per cent in the last year and in fact, every sector of the economy except agriculture and public administration has slowed down by varying magnitudes. The gross fixed capital formation is estimated to decline from 29 per cent in 2015-16 to 26 per cent in the current year. The Economic Survey acknowledges the negative impact of demonetisation, but asserts that the slowdown is likely to be limited to 25 to 50 basis points, which considering the disruption in both production and consumption caused by the note ban seems to be a clear underestimate. The CMIE's estimate of new investment during the last quarter at INR 1.25 trillion was virtually a half of the average investments recorded during the 9 previous quarters.

2. FISCAL AUSTERITY AND RISKS

The Finance Minister must be complimented for continuing the process of fiscal consolidation. He has showed the intention not only to reduce the overall fiscal deficit but also improve the quality of deficit by compressing both revenue and primary deficits (Table 1). The estimate of fiscal deficit in

2017-18 at 3.2 per cent is proposed to be lower than the current year's estimate of 3.5 per cent and the revenue deficit contained at 1.9 per cent. Although the fiscal deficit estimate for 2017-18 is higher than the target of 3 per cent set by the FRBM Committee, in the prevailing environment the slippage should not be grudged. Even as the Committee recommended relaxation of 0.5 per cent for exceptional exigencies, the Finance Minister has continued the path of austere fiscal stance by not invoking this clause.

Unfortunately the report of the FRBM committee is still not available in public domain to make any informed observations on it. However, it appears that the Committee has set debt-GDP ratios as a target and derived the fiscal consolidation path from it. In other words, the fiscal deficit of 3 per cent was derived to achieve the consolidated debt-GDP target of 60 per cent and the Union government's debt-GDP ratio target of 40 per cent from the prevailing level of 47 per cent. Conceptually it is difficult to justify taking debt–GDP ratio as the target and fiscal deficit as a means of achieving the target because, it is difficult to define and measure optimum debt and in fact, debt–GDP ratio can be brought down without reducing the fiscal deficit, by simply inflating the economy. While it makes sense to target primary deficit going by the debt-dynamics equation and as persuasively argued in the Economic Survey, it must be noted that the interest payments at the Union level constitute over 36 per cent of the revenues and therefore, it is important to bring down both fiscal deficit and outstanding debt. In fact, the consolidated fiscal deficit target set by the 12th Finance Commission of 6 per cent was based on the size of the household sector's financial saving. The argument was that as the household sector's financial saving relative to GDP was 10 per cent and foreign inflow was 1.5 per cent pre-empting 6 per cent to the government (3 per cent each to Centre and States) and 1.5 per cent to the public sector enterprises will leave 4 per cent borrowing space to the private sector.

An important aspect of the budget this year is that the projections have not been too optimistic and therefore, risks to achieving the fiscal deficit target are not substantial. The most important source of risk however, is the disinvestment estimate of INR 72500 crore as against current year's revised estimate of INR 45500 crore. Apart from this, it appears, the budget has not adequately factored in the impact of demonetization in the revised estimate of the current year particularly in respect of personal and corporate income taxes. The budget simply reproduces the budget estimates for these taxes as revised estimates at INR 326463 crore and INR 493923.50 crore respectively. In the case of personal income tax, the projections for 2017-18 are higher than the revised estimate (as well as the budget estimate) by almost 25 per cent. Perhaps, this is predicated on the assumption that the surgical strikes on the suspicious bank accounts in which deposits of more than INR 5 lakh were made will yield substantial revenues in the next year.

There has been a clamour for initiating the Universal Basic Income (UBI) in this budget and the Finance Minister eschewed the temptation. 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 INR 2.7 trillion constitute 1.6 per cent 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 fertilizer subsidy alone constitute INR 2.4 trillion.

Table 1 Summary of the Budget (Per cent of GDP)					
	2014-15	2015-16	2016-17 BE	2016-17 RE	2017-18
I. Revenue Receipts	8.86	8.74	9.06	9.44	9.00
a. Tax Revenue - Gross	10.01	10.60	10.73	11.26	11.29
b. Tax Revenue - Net	7.27	6.90	6.94	7.22	7.28
c. Non-tax revenue	1.59	1.84	2.13	2.22	1.71
II. Non –debt Capital Receipts	0.41	0.44	0.46	0.37	0.50
a. Recovery of Loans	0.11	0.07	0.15	0.07	0.07
b. Disinvestment receipts	0.30	0.37	0.31	0.30	0.43
III. Total Receipts (excluding borrowings)	9.27	9.20	9.51	9.82	9.50
IV. Total Expenditure	13.38	13.09	13.02	13.36	12.74
Revenue	11.80	11.24	11.39	11.51	10.90
Grants for Capital	1.05	0.96	1.10	1.14	1.16
Capital	1.57	1.85	1.63	1.86	1.84
Revenue Deficit	2.94	2.51	2.33	2.06	1.91
Effective Revenue Deficit	1.89	1.54	1.23	0.93	0.75
Fiscal deficit	4.11	3.90	3.51	3.54	3.24
Primary Deficit	0.87	0.67	0.27	0.34	0.14

Source: Budget at a Glance 2017-18 and 2017-18

3. REVIVING THE INVESTMENT CLIMATE

One of the most important tasks of the budget was to take measure to provide impetus to investment activity. The difficult international environment and poor domestic climate marked by the twin balance sheet crisis required a strong impetus and in this task, the budget has failed. The growth so far has been sustained by only private consumption and even public consumption is not likely to be important as the impact of pay revision wanes. As regards exports, it has merely started in the positive territory after several months of decline. Private investment activity is completely stalled and as mentioned earlier, the CMIE's estimate of investment during the last quarter at INR 1.25 crore is virtually a half of the average investment during the previous 9 quarters. The Gross Fixed Capital Formation (GSFC) at 26 per cent of GDP in 2016-17 has fallen to the lowest level during the last 15 years.

In a situation where the growth scenario is severely hampered by poor investment climate, the most important initiative the government should have taken to revive the investment climate is to substantially step up in public investment. There is no possibility of the private investment kicking anytime soon because of the twin balance sheet crisis. The corporates are burdened with overhang of indebtedness and poor returns, and the banks are unwilling to lend due to their own overhang of NPAs. In this situation, it is not certain that the virtuous cycle of investment will kick in even at low rates of interest. The demonetisation adventurism has only complicated the investment climate further. The only viable option to revive the investment climate at present is to substantially increase the public spending on infrastructure and that would require phasing out unproductive subsidies and transfers on the one hand and increasing tax-GDP ratio on the other. On either count, the budget has failed. Enhancing public investment in infrastructure would have helped to crowd in private investment and create a virtuous cycle. Although the revised estimate of investment spending in 2016-17 at 1.8 per cent of GDP was marginally higher than the budgeted (1.6 per cent), the capital expenditure it remains at the same level at 1.8 per cent in 2017-18 and this is just about 10.7 per cent higher than the revised estimate of the previous year. In fact, even within this, the capital expenditure under defence is about 0.5 per cent of GDP the impact of which will spill over the country through imports. Thus, the capital expenditure planned for next year at 1.8 per cent of GDP is only marginally more than the subsidies (1.6 per cent) and almost a half of the interest payments.

4. TAX MEASURES

As mentioned earlier, the revised estimate of both personal income and corporate income taxes for 2016-17 are exactly the same as the budget estimate of the year up to the last number. This implies that either the tax departments have acquired such skills in forecasting which can beat the best or given the uncertainty following the note ban, the government simply decided to repeat the budgeted numbers in the revised estimate. The problem is that the revenue from personal income tax is assumed to increase by 31 per cent in 2016-17 over the previous year and in 2017-18, it is assumed to increase further by 25 per cent. The increase the tax-GDP ratio during 2016-17 and 2017-18 (Table 2) is primarily predicated on the strength of this. Without having an authentic revised estimate, there is a strong suspicion that the budget estimate could be optimistic.

Table 2

Trends in Tax Revenues

(Per Cent of GDP)

	2014-15	2015-16	2016-17 BE	2016-17 RE	2017-18 BE
Corporation Tax	3.44	3.31	3.28	3.28	3.20
Income Tax	2.06	1.98	2.34	2.34	2.62
Customs	1.51	1.54	1.53	1.44	1.45
Union excise Duty	1.52	2.11	2.11	2.57	2.42
Service tax	1.35	1.55	1.53	1.64	1.63
UT Taxes	0.03	0.03	0.03	0.03	0.03
Total	9.99	10.60	10.82	11.26	11.29
States Share	2.71	3.83	3.78	4.03	4.00
Net Central tax	7.25	6.73	6.99	7.22	7.28
Stare' Share in total	27.14	36.15	34.97	35.83	35.47

Source: Budget Documents

On tax proposals, the picture is mixed. Reduction in the rates of tax for companies with less than INR 50 crore turnovers to 25 per cent from the existing 30 per cent potentially benefits 96 per cent of the companies. However, the measure is not likely to improve the investment climate for, only a fraction of the companies below INR 5 crore turnovers earn profits and after demonetisation, quite a few of them have joined the ranks of loss making. At the same time, very little has been done to rationalise tax preferences and reduce the rate to 25 per cent for all corporates by 2019, which was promised by the Finance Minister in the 2015-16 budget. On personal income tax, the reduction in the tax rate to 5 per cent for individuals up to INR 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 INR 50 lakhs to INR 1 crore at 10 per cent in addition and the present surcharge on those earning more than INR 1 crore at 15 per cent 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 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 INR 20 lakh, the threshold for GST decided in the Council.

5. TRANSFERS TO STATES

The total current transfers to the States as a ratio of GDP shows an increase after the implementation of Fourteenth Finance Commission's award. The increase in 2015-16 over the previous year was by about 60 basis points (from 5.5 to 6.1 per cent) and the revised estimate for 2016-17 shows an increase of another 50 points due to both higher estimate of tax devolution and grants. However, the realisation of this will depend on whether or not the actual collection of revenues is equivalent to the revised estimate. As mentioned earlier, the revised estimates do not seem to have taken account of the adverse effects of demonetisation and the actual could well be lower.

There has been a vociferous claim that the FFC has been overly generous in recommending higher transfers to the states. A close look at the table shows that the transfers to States as a ratio of central gross revenues is lower in 2015-16 i.e. the first year of the FFC award as compared to 2011-12, the second year of the Thirteenth Finance Commission award (Table 3). In fact, the trend in transfers shows a decline in the share of States and this is partly due to the practice of raising additional revenues from taxes by levying cesses and surcharges. While the share of tax devolution increased in 2015-16 substantially owing to the FFC recommendations, there was a sharp reduction in the grants thereby reducing the overall share of the States in central tax revenues.

Table 3

Transfers to States

	Per cent of GDP			Per cent of Gross Central Tax Revenues		
	Tax Dev	**Grants**	**Total**	**Tax Dev**	**Grants**	**Total**
2011-12	2.89	3.43	6.32	28.70	34.06	62.76
2012-13	2.91	2.99	5.90	28.10	28.87	56.97
2013-14	2.78	2.46	5.24	27.95	24.67	52.62
2014-15	2.71	2.74	5.45	27.14	27.39	54.53
2015-16	3.70	2.36	6.06	34.91	22.29	57.20
2016-17 RE	4.03	2.50	6.53	35.83	22.20	58.04
2017-18 BE	4.00	2.41	6.41	35.47	21.38	56.85

A careful analysis of major Centrally Sponsored Schemes shows that in 2016-17, significant additional allocations are made for MGNREGA (24.7%), National Health Mission (30.7%), ICDS (27.6%) and Swachch Bharat Abhiyan (44.8%) over the budget estimate. Some of these sectors, particularly, National Health Mission (20%), ICDS (25.2%) and Swachch Bharat (26.9%) received substantially higher allocations in 2017-18 budget over the revised estimate of the previous year. Other sectors receiving higher allocations in 2017-18 are Prime Minister's Awas Yojana (38.7%) and Rashtriya Krishi Vikas Yojana (32.6%). Perhaps, sustained advocacy to increase the allocations to social sector schemes seems to have had their effect in enhancing outlays for ICDS and the health sector.

6. CONCLUDING REMARKS

On the whole, this is a 'business as usual' budget which could have passed the test in ordinary times. These are unusual times and much was expected in the budget to kick-start the virtuous investment cycle. It does well to be prudent in proposing to control the fiscal deficit. A marginal relaxation in the target by 20 basis points may not be grudged in the prevailing difficult economic climate. However, it does very little to revive the investment climate in the country. The capital expenditure as a ratio of GDP is static and the promised clean-up of tax preferences to reduce the corporate tax rates is yet to be initiated. The Finance Minister has lost the opportunity to prune the exemption list and align the excise duty rates in preparation to the GST implementation. Finally the measures to reduce cash donations and introduction of bonds to political parties is more cosmetic and is not likely to have any impact on cleaning up political funding as long as anonymity of donors is assured.

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