BUDGET THE FINE PRINT

Fiscal slippage a concern

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Budget speeches always focus on the good news. Bad news, like the worrying slippage in fiscal consolidation this year, are pushed into the background. Arun Jaitley's speech was no different. But the Budget's impact on the economy requires a dispassionate assessment of the data.

The 2017-18 fiscal deficit ended up at 3.5 per cent instead of the targeted 3.2 per cent and the 2018-19 target is now raised to 3.3 per cent. In absolute terms, the fiscal deficit went up by 33.6 per cent in April-December 2017 and the revenue deficit by as much as 40.7 per cent compared to the same period the previous year (<Macroeconomic Framework Statement>). The primary deficit, ignoring committed interest payments, went up by a whopping 58 per cent! That's a massive fiscal stimulus compared to the nominal GDP growing of only 9.5 per cent. The Budget indicates that the fiscal parameters will be loosened even further in 2018-19.

Counter-cyclical policy requires fiscal contraction when growth is on the rise, especially if there are risks of a spike in inflation. At present, growth is recovering as the Economic Survey points out. After declining for several quarters, it turned around in the Q2 of 2017-18 and that has been sustained in the second half of the year.

The Survey's growth projection of 7 per cent to 7.5 per cent for 2018-19 is similar to that of the IMF and others. Moreover, oil prices have started spiking with Brent crude approaching $65-$70 a barrel. This will build up inflationary pressures along with stress on the external and fiscal deficits. It is a classic situation calling for fiscal compression. Instead, the Budget is pump priming demand. Are electoral compulsions trumping fiscal prudence or is there more to the story?

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Typically, populist sops could be expected on the expenditure side. However, total expenditure is set to grow at 10.1 per cent, lower than the projected nominal GDP growth of 11.5 per cent. Spending on economic services is budgeted to grow by 11.6 per cent, about the same as nominal GDP, the bulk of it for infrastructure. Despite the chatter about helping farmers, agriculture (including irrigation) and rural development account for less than 13 per cent of the expenditure. Social spending is budgeted to grow by 9.8 per cent, with a maximum increase of 20.6 per cent for education. Despite the focus on health insurance for the vulnerable, health expenditure will grow by less than 6 per cent, while education spending will grow by an impressive 21 per cent. Altogether, social sector spending will grow at 9.8 per cent and continue to account for under 5 per cent of government spending. So, no major shifts in the scale or structure of spending.

The primary explanation for the fiscal loosening has to be sought on the receipts side. It could be expected that introduction of the GST, a massive reform which is yet to stabilise, could account for the slippage. But indirect tax receipts have, in fact, grown by over 19 per cent compared to 8.7 per cent last year, its share of total revenue receipts rising to nearly 47 per cent. Direct taxes accounting for 48 per cent of total receipts have grown by 14.4 per cent.

The main slowdown is in non-tax revenue receipts, which increased by less than 4 per cent, mainly on account of a less than one per cent increase in dividends and profits of public enterprises and the RBI, a sharp slowdown in receipts from power and petroleum and decline in capital receipts.

So, it is neither profligate election-year spending nor tax revenues, but non-tax revenues and capital receipts that account for the fiscal slippage

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