Budget again reveals structural fiscal constraint

It recognises it cannot afford space for expansionary fiscal policy

THE FISCAL FRAMEWORK

RATHIN ROY

In my column on the FY20 Budget (*A silent fiscal crisis*, July 5, 2019), I had warned that the government faced a structural fiscal constraint that was concealed by using incorrectly optimistic numbers for revenue receipts. This year's Budget is transparent. But the government continues to be heavily fiscally constrained due to inadequate revenue receipts. A large part of the incremental fiscal deficit is because of this constraint.

In FY20, gross tax revenue receipts are ₹3 trillion lower than projected in the budget estimates. Half of this is because of a shortfall in corporate taxes, which is more than the number projected when tax rate cuts were announced. The other half is due to a fall in indirect taxes of ₹1.32 trillion. Collectively, this means that the shortfall in gross tax revenues in FY20 is 1.46 per cent of gross domestic product (GDP). The shortfall in net tax revenue to the Centre is 0.7 per cent of GDP and 0.75 per cent of GDP for the states. This reflects the disproportionate impact of a tax shortfall on states caused by the high share of cesses (which were not, for example, affected by the tax rate cuts). So the fiscal stress is now impacting the states, a fact that the Fifteenth Finance Commission's interim report seems to have conveniently ignored.

A consequence of this shortfall, and an additional shortfall in disinvestment receipts, is that total expenditure has fallen by 0.43 per cent of GDP despite an increase in the fiscal deficit-GDP ratio from 3.3 to 3.8 per cent and an increase in non-tax revenues by 0.16 per cent of GDP. This is, therefore, a contractionary, not an expansionary Budget. Perhaps for this reason, the finance minister was silent in her lengthy speech about the growth slowdown, and whether and how expansionary fiscal policy would be deployed to address it.

But I am comforted by the realistic FY21 BE (budget estimate) projections, which forecast a fall in net tax revenues as a percentage of GDP. But an increase in the expenditure-GDP ratio by 0.33 per cent of GDP in FY21, even in the face of falling tax- GDP ratios, is puzzling until one sees that disinvestment receipts are projected to more than triple from ₹65,000 crore to ₹2.1 trillion in FY21. So a massive increase in asset sales will finance a modest increase in the expenditure-GDP ratio plus reduce the fiscal deficit! On current form, I do not find this credible.

It is interesting that in FY21, the revenue deficit-GDP ratio rises to 2.7 per cent from 2.4 per cent in FY20 RE (revised estimates). This means that total borrowing for capital expenditure ratio will actually fall in FY21 to 0.8 per cent of the fiscal deficit compared with 1.4 per cent in FY20. So the strategy for FY21 is to fund increased revenue expenditure through disinvestment sales.

The government is to be commended for explicitly listing its off-budget borrowings in statement 27 of the Expenditure Profile, which remain consistently at 0.8 per cent of GDP. Total government borrowing is 4.6 per cent of GDP this year and is projected (with 10 per cent nominal growth, which I consider reasonable) at 4.3 per cent next year. Economists would be well advised to start using these real figures and not the reported fiscal deficit number. The bulk of this additional expenditure in all three years goes to fund the activities of the Food Corporation of India. I do not think this expenditure in any way addresses the growth slowdown. This reinforces my judgement that the government simply does not have any fiscal space to devote to expansionary fiscal policy.

I was hoping to see expenditure switching policies to address the growth slowdown. Unfortunately, it continues to be the case that committed expenditure (expenditure on establishment, GST cess, interest payments, statutory and finance commission transfers) is constant at between 6.8 and 7 per cent of GDP from FY19 through to FY21 BE. Thus, over half of government expenditure is locked down. As to the other half, there is a reduction in the share of subsidies which has been used to increase the share of central sector schemes.

For uncommitted expenditure in FY20 RE, spending on agriculture grows by 28 per cent in FY21 compared with FY20. Other than that and the surprisingly small ₹12,500 crore allocation to the infrastructure pipeline, no development expenditure allocation has increased by more than the nominal GDP growth rate of 6.5 per cent. Many, like education, energy, and rural development have increased by much less.

Thus, in the case of the FY20 RE, the entire increase in fiscal deficit was insufficient to maintain expenditure-GDP ratios at budgeted levels. The revenue deficit will drop this year but rise in FY21 with a concomitant fall in borrowing allocated for increased capital expenditure. Committed expenditure continues to rise and the structural stagnation in the tax-GDP ratio is expected to persist in FY21. This is a sobering Budget as it reveals clearly what I have been continuously emphasising: That the medium-term fiscal arithmetic does not afford space for expansionary fiscal policy.

Finally, the casual reference to the escape clause by the FRBM (Fiscal Responsibility and Budget Management) review committee is not credible. The clause was to be invoked on the advice of an independent fiscal council, which has not been constituted. There is not a word in the Budget that analytically explains why the clause has been invoked. The government has presented no plan which evinces a road map to returning to fiscal prudence as recommended by the FRBM committee. And worst of all, as I have shown, the increased fiscal space has only been used to plug a hole in tax revenues. In effect, this invocation is spurious and cannot hide the fact that the medium-term fiscal position is weak and, therefore, it is futile to pretend that a controlled return to the FRBM path is a credible objective.

The writer is director, National Institute of Public Finance and Policy. Views are personal