India Deserves a More Comprehensive Budget Process

From fiscal goals and meaningful allocations to boosting growth and being accountable, Budget 2020 provides the opportunity for a new narrative.

Unlike earlier years, the 'economics of the government' is no longer exclusively revealed on Union budget day, where the finance minister would announce new economic policies and schemes, much like a magician does by taking out a rabbit from her hat.

Today, significant economic policy announcements take place throughout the year, outside the purview of the budget speech day.

Indeed, important fiscal announcements have happened prior and post to budget, especially those that relate to capital formation and investment. Unanticipated fiscal announcements like demonetisation have come outside the purview of the budget. Major tax cuts for the corporate sector were also announced in September 2019 as part of the government's attempt to restart a slowing investment cycle.

With this trend, "budget credibility" becomes an important issue in the changing scenario. The difference between what is promised in the budget and the budgetary allocations to back up the announcements – this gap has not yet been technically analysed consistently. Higher budgetary allocations per se is not higher spending. This gap has, over time, reduced the credibility of the budget.

Policy uncertainty and unanticipated fiscal announcements deter an investor's confidence and macroeconomic stability. The last budget announcement (FY' 2019-20) was less about fiscal arithmetic and more about the political vision of the government.

Rules-based fiscal and monetary policy regime

Both fiscal and monetary policies have become rule-based in India. Budget-making or the fiscal policy road map is governed by the Fiscal Responsibility and Budget Management (FRBM) Act. On the monetary policy side, the Union budget a few years back announced a "New Monetary Framework". Post this announcement, the Centre and the RBI had signed an agreement. This agreement required monetary policy authorities to have only a single objective, i.e., inflation targeting. Any other intervention by the monetary authority, involving a whole range of other macroeconomic issues, should be done to control inflation.

On the fiscal policy front, has the FRBM Act, which imposes a borrowing limit by the government, affected budget-making in India? A roadmap towards fiscal consolidation has been put on board with specific rules for debt and deficits for Union and state level governments, assuming that fiscal discipline is economic growth inducing. Has the fiscal consolidation induced economic growth? The evidence is mixed. There is an increasing recognition regarding the economic and social costs of maintaining rule-based fiscal prudence.

Gross capital formation has suffered over the years, as excessive deficit procedures focused on "targets" rather than "routes" to fiscal consolidation. It is now state governments that have been spending relatively more on capital formation than the Centre. Previously, one used to wait for Union budget to get a sense of roadmap to gross capital formation – especially infrastructure investment decisions – and their finance.

However, with the recent policy transition of infrastructure financing through PPP models and almost stagnant capital spending at the Union level, such announcements are conspicuously absent in the budget and, even when it is made, questions are raised about its financing. Thus, there is a clear shift in budget-making, against the backdrop of this clear transition in the macroeconomic policy making, from discretion to 'controlled discretion" and to "rules".

Institutions

With the closure of Planning Commission, how can the regional inequalities be tackled is an important question to be dealt with. Along with the budget, the 15th Finance Commission (FC) award will also be announced in February 2020. Can 15th FC play a role of an inclusive economic institution in the federal polity and address the inequities is a matter of concern, given its terms of reference?

Yet another federal institution is the GST Council. Even after two years, why the GST regime has not stabilised is an issue. Budget 2020 should provide some insights on the GST revenue mobilisation and the central government's thinking in this regard. There is a clear disconnect between legal and fiscal institutions to tackle these in equanimity.

Revival of economic growth

The role of fiscal policy in triggering economic growth in the context of the current economic slowdown is critical. Can budget 2020 deliver on this? It is highly debated whether a "fiscal stimulus" can lead to a growth turnaround. Some economists argue that the growth slowdown in India is relatively "structural" in nature and the policies to tackle structural constraints should be given more significance. It is highly debated whether "budgetary policies" as a countercyclical policy tool is effective in the present context, to announce "fiscal stimulus packages".

The question of whether growth slowdown is "cyclical versus structural" needs a context-specific treatment, as it can be cyclical in certain sectors while non-cyclical in other sectors. This cyclicality cannot be debated as a fallacy of aggregation, linked to the debate whether "business cycles exist" in emerging economies like India. The paper titled *Cycle is Trend* by Mark Aguiar and Gita Gopinath flags that there may not be evident "business cycles" in the context of emerging economies.

However, the cyclicality needs to be analysed specific to the country-context. For instance, from a historical perspective, RBI has embarked a sectoral policy initiative of boosting credit to selective sectors where empirical analysis showed that monetary leveraging – though excess leveraging can induce a crisis – can act as countercyclical policy tool – for instance, the credit was boosted in infrastructure sector, and not in housing. This was discussed by Y.V. Reddy in Taylor's Bank of International Settlement (BIS) Talk on "The Great Leveraging".

Does democracy determine budgetary decisions?

In recent budgets, there is a clear link between expenditure decisions and the "last mile connectivity" – for instance, providing clean fuel to women in poor income households. If the social sector budget (and its last mile connectivity) is one of the significant determinants of majority in winning elections, budget frameworks have increasingly focused not just on "financial inputs", but also in "monitoring the outcomes".

"Beyond economic growth" paradigm is hardly absent in budget announcements. The "LNOB" (Leave No One Behind) has been the policy narrative of the Modi government to achieve the SDGs. There are related budget announcements to address these concerns. These LNOB framework is tightly linked to election mandate as well. However, many policy announcements – including doubling income of farmers – have not been clearly backed up by allocations and the roadmap.

The impact of unanticipated fiscal announcements on economic growth – like demonetisation – needs an evaluation, and a policy course correction. The only analysis available now is a study by Gita Gopinath and her co-authors to understand the impact on growth, especially in the informal sector, based on the night light intensity/luminosity. Based on the nightlights-based satellite data, they found that districts experiencing more severe demonetisation had relative reductions in economic activity and lower bank credit growth.

Transparency and accountability of budget

Finally, the accountability mechanisms of budget – especially policy audits by CAG and an informed debate in parliament on "demand for grants", when it is back in session after the budget recess – are some of the crucial entry points in which the transparency and accountability of the budget process can be strengthened.

There is also an increasing recognition to move ahead to an effective medium term fiscal framework from the annual budget cycles, for the political and economic sustainability of the fiscal policies.

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