A confident and optimistic report

In a Budget celebrating the achievements in the last decade, there are few announcements with any fiscal magnitude attached

THE FISCAL FRAMEWORK

R KAVITA RAO

In the spirit of an Interim Budget, the Budget speech of Union Finance Minister Nirmala Sitharaman provided a recap of the achievements in the last 10 years and made some broad announcements on the path ahead in the coming years on the presumption her party, the Bharatiya Janata Party, would return to power. The lack of a perceived need for new announcements points to a confident government. Two significant announcements relate to the adherence to fiscal consolidation with an announced fiscal deficit to gross domestic product of 5.1 per cent for 2024-25 and an attempt to clean up the direct tax litigation backlog through a write-off of small liability demands.

Budget maths and fiscal responsibility:

Adherence to fiscal responsibility commitments has been presented as a significant focus of the government. For 2023-24, in spite of clocking lower growth in nominal gross domestic product (GDP), the Revised Estimate suggests a fiscal deficit moderately lower than the Budget Estimate at 5.8 per cent. This has been achieved through an increase in revenue receipts of ₹71,232 crore and decline in the capital outlay of ₹59,412 crore, which allowed for a modest increase in revenue expenditure of ₹40,000 crore along with a decline in the fiscal deficit. Turning to the Budget Estimates for 2024-25, the proposed reduction in the fiscal deficit as a percentage of GDP once again is proposed to be achieved through robust growth in tax revenue of 11.94 per cent and of non-tax revenue of 6 per cent. With growth in revenue expenditure capped at 3 per cent and capex budgeted to increase by 16.9 per cent, the nominal numbers suggest a decline in the fiscal deficit by ₹50,000 crore. Clearly, the performance in tax revenue collection is crucial in realising these projections.

The buoyancy assumptions underlying the Budget maths suggest robust growth in corporation tax, income tax, and central goods and services tax

In understanding this Budget, there are two crucial issues to examine: First, the credibility of the underlying growth assumptions, and second, the assumptions of tax buoyancy. The nominal GDP numbers underlying the Budget Estimates suggest growth of 10.5 per cent. With real GDP expected to grow at 6.5-7.2 per cent according to available forecasts, inflation measured using the GDP deflator needs to be over 3 per cent. The advance estimates of GDP for 2023-24 suggest deflator-based inflation at 1.6 per cent. One driver of the deflator is international commodity prices, which are forecast to decline during 2024, implying a downside risk.

The importance of the GDP deflator for the Budget maths highlights the need for closer analysis of the deflator for more effective forecasting of Budget numbers. This issue gains importance, given the divergence between trends in the GDP deflator and consumer price index (CPI), especially in the context of inflation targeting, which focuses on the CPI. The idea of implicitly assuming the same levels of inflation for both the indicators can be misleading in the context of Budget formulation.

Turning to the other aspect, the buoyancy assumptions underlying the Budget maths suggest robust growth in revenues in corporation tax, income tax, and central goods and services tax. The estimated growth in revenue under these three heads is around 13 per cent, while Customs and union excise duties are estimated to grow 5-6 per cent. With nominal GDP growth of 10.5 per cent, the estimated growth numbers suggest a buoyancy of 1.25. The performance of these taxes in the post-pandemic era has been improving sharply. In 2023-24, for instance, collection in taxes till December 2023 shows a year-on-year growth rate of 18 per cent for corporation tax, 28 per cent for income tax, and 13 per cent for central goods and services tax. An important question to ask is whether this robust growth in revenue even in the face of relatively modest growth in nominal GDP is on account of expanding economic activities or on account of improved compliance and administrative interventions. If it is former, the assumptions on buoyancy will be well founded while if it is latter, it is more likely that these improvements would result in a level correction rather than a correction in the growth rate itself.

Announcements in the Budget

In a Budget celebrating the achievements in the last decade, there are few announcements with any fiscal magnitude attached. The only two are: One relating to research and development and other to tax disputes. The former is a commitment to create a fund of ₹1 trillion to provide zero-interest or low-interest loans of long duration to support and "scale up research and innovation significantly in sunrise domains". With India aiming to become the third-largest economy in the near future and a developed country in the not so distant future, expanding the country's footprint in research, innovation, and technology would be critical for the country to move up the value chain and gain from ownership of intellectual property. This renewed focus is, therefore, welcome, especially since it would be expected to build on other announced initiatives like the National Research Foundation in Budget of 2021-22 and a variety of sector-specific programmes to support innovation announced in Budget of 2023-24.

The other announcement to note is the write-off of disputed liabilities in direct taxes if the disputes pertain to the period before 2014-15 and are of small value — less than ₹25,000 for demands pertaining to any year before 2019-10 and less than ₹10,000 for demands pertaining to the period 2010-11 to 2014-15. The liabilities in disputed and undisputed — but uncollected — direct taxes over 10 years old are ₹1.63 trillion. The proposed write-off would perhaps reduce the liabilities here by ₹15,000-20,000 crore, ie the overall liability of uncollected direct taxes wouldn't change significantly. This proposal, however, would represent a decent clean-up of low-return high-cost cases — a step in the right direction for building a nimble tax administration.

The writer is director of National Institute of Public Finance and Policy