Budget well meaning, but may miss deficit target

BY INVITATION

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CASTING THE NET WIDE BUT UNSURE IF THE CATCH WILL BE GOOD

Expectations from the Budget for 2020-21 were running high because of the background against which the Budget had to be prepared. There were three disturbing trends in the economy — a perceptible slowdown in growth, a steep fall in investment rate and a stressed financial system. The Budget was expected to address all these issues and also lay the foundation for a significantly faster economic growth. Otherwise, the $5 trillion economy will be only a distant reality.

Overall, the budget is well intentioned, even though it does not use the word 'slowdown' even once. It outlines at length the multiple objectives it seeks to achieve. While the expenditure programmes may show how demand will be revived, the revenue projections along with the fiscal deficit will indicate whether these expenditure programmes are sustainable. It is to this scrutiny we turn our attention.

While the fiscal deficit in the current fiscal goes to 3.8%, the projected fiscal deficit for 2020-21 is 3.5%. While these levels are above the implicit mandate of 3% of GDP, they are nevertheless at reasonable levels considering the overall compulsion to raise government expenditures to stimulate demand. However the question is whether the 3.5% fiscal deficit will stick.

The nominal GDP in 2019-20 is assumed to grow by 10%. This is realistic. The gross tax revenue is assumed to grow by 12%. Thus the buoyancy is greater than one which did not materialise in the current year. The reliance on disinvestment is high while there may be special circumstances such as LIC disinvestment which may be helpful. However, the disinvestment target has in the past not been fulfilled in any year.

The finance ministry will have to monitor the revenue growth so that expenditures must be adjusted such that the fiscal deficit can be maintained. In fact, taking the expenditures as given, the possibility of the government exceeding the budget's fiscal deficit is very much there. The escape clause should be seen as permitting the government to exceed the implicit mandate of 3% rather than over and above what is budgeted. It is hoped that the government would not by invoking the 'escape clause' ask the RBI to enter the primary market in government paper.

Some of the changes in the tax regime are significant. A major effort was made some months ago to cut the corporation tax rate. In this budget, some steps have been taken in the direction of simplifying personal income tax. The impact of this may be very limited. In fact, the broad principle of reducing the tax rate along with withdrawing exemptions must be taken to the logical end and must cover the entire gamut of personal income tax. We should move towards a single regime rather than give options.

Several of the measures proposed may help to accelerate the inflow of funds from abroad. The withdrawal of Distribution Dividend Tax is welcome, particularly on equity grounds. While relaxation in investment by non-residents in government paper in rupee terms is acceptable, caution must be exercised. Easy access should not pave the way for larger borrowing.

Bulk of the time was spent by the finance minister on explaining the various programmes in different sectors. Quite clearly, sector experts must examine how relevant these expenditures are. More importantly, much depends on how they are implemented. The overall expenditures show a rise of 12%. Within that, capital expenditures are expected to increase 18%. However, the ratio of capital expenditures to GDP stays at 1.8% which is the average over the past few years.

The financial sector has come in for special treatment. Reforms are needed to strengthen the financial system and move it forward. As far as the banking system is concerned, the crucial question is not so much mergers as the extent of the total banking system which the public sector wants to own. The action relating to IDBI gives us some idea. But more clarity is needed. The second important reform measure is to determine the 'arm's length' between the government and the board of management of public sector banks. Efficiency is a function not only of technology but also the structure of the organisation.

The budget was expected to stimulate demand and to raise the level of capital formation which had fallen by six percentage points over the last eight years. The level and pattern of government expenditure is key to stimulating demand. If the expenditure programmes are put through with dedication and commitment, it will help in this direction.Implementation is the key. As for stimulating investment, the government's own participation is still limited. In fact in 2020-21, of the total fiscal deficit of 3.5%, revenue deficit is 2.7%. The driver of deficit is not investment. Much of the overall capital expenditure of government comes from extra budgetary resources. Therefore a lot depends on the pickup of private investment. Will the budget help to create a favourable investment sentiment? Only time will tell.

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