Falling Short in the Fiscal Test

OUR EXPERTS ANALYSE WHY **BUDGET 2020** MAY NOT HAVE ALL THE SOLUTIONS TO INDIA'S ECONOMIC WOES

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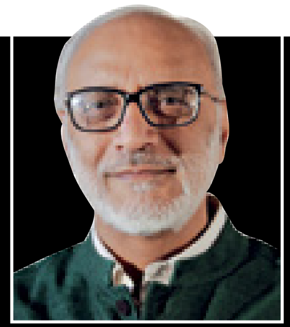
Q. Does the Union Budget present a coherent economic vision, a road to economic recovery?

Answer:

● **ASHOK GULATI:** The budget is woven around three prominent themes: (a) Aspirational India, where all segments seek a better living; (b) Economic development for all; and (c) a caring society. My reading is that this is another pedestrian budget on the beaten track and cannot lead to the economy's recovery to its high growth path on a sustainable basis. I am particularly concerned about agriculture, which engages 44 per cent of the workforce. I see a lot of repetition of the PM's talk of "doubling farmers' incomes by 2022". The budget lists 16 measures that are in the right direction, but nowhere close to that goal. Doubling farmers' incomes would require almost a 15 per cent per annum growth in their real incomes in the next three years. Can this be achieved? I wonder at the very lack of understanding of issues, the challenges involved and the sincerity needed to address them in a transparent manner. Lack of transparency adversely hits the credibility of the government.

● **MAITREESH GHATAK:** No, the budget tried to balance fiscal discipline and the need to provide a growth stimulus and ended up with a compromise that did not satisfy either objective. That the overall fiscal constraints were tight was known beforehand. So, a massive fiscal expansion was not on the cards. This is a contractionary budget. Total expenditure as a percentage of GDP has fallen marginally despite an increase in the fiscal deficit-GDP ratio from 3.3 to 3.8 per cent.



> "Doubling the incomes of farmers would require almost a 15 per cent per annum growth in their real incomes in the next three years"
>
> **Ashok Gulati, Infosys chair professor, ICRIER**

● **D.K. JOSHI:** The budget focuses on lifting the trend rather than the cycle. With the fiscal deficit print straying from the Fiscal Responsibility and Budget Management path, at 3.8 per cent of GDP compared with the budget estimate of 3.3 per cent for fiscal 2020, the government had little room for the big spends needed to push growth. However, the budget creates fiscal room by relaxing the deficit target for fiscal 2021. A number of steps (in agriculture, health, education, bond market development, raising capital expenditure) may not yield immediate dividends, but they create an upside to medium-term growth, provided reforms are pursued relentlessly and supported by resources over the years.

● **AJIT RANADE:** I would have liked to see an acknowledgement of the economic context of a serious slowdown. A roadmap needed to be spelt out on how the goal of a $5 trillion economy would be achieved. The budget provided some consumption stimulus in the form of tax cuts, and there is also some provision for the National Infrastructure Pipeline. But the road to recovery is not clearly spelt out.

● **JAHANGIR AZIZ:** The dominant narrative among policymakers and in much of the market is that India's economic woes are the unintended consequences of policies, such as demonetisation and GST, and the liquidity crunch. This is far from reality. India's growth had started to decline well before any of these shocks hit the economy. The languishing global trade inflicted most of the damage. The challenge is to search for new engines of growth. This, unfortunately, is not being discussed in the market or in the policymaking circles.

● **N.R. BHANUMURTHY:** While the budget covers a wide canvas, it succeeded only partially in providing a medium-term vision. Bringing down personal income tax rates, largely to provide stimulus, could help. But that depends on how it will impact disposable incomes. A stimulus through expenditures is missing. While the Economic Survey had argued for an imports-led export growth policy, the budget has done the opposite—brought in more commodities under the duty structure and also hiked rates in a few cases. Such protectionist policies do not augur well for medium-term growth. Despite invoking the escape clause twice, which is unprecedented, the budget does not provide resources for capital expenditures. It is declining from 1.4 per cent of GDP in 2019-20 to 0.8 per cent in 2020-21. The recovery could take longer time than anticipated.

Q. Does the budget address big concerns around private corporate investment/ jobs?

Answer:

● **ASHOK GULATI:** While corporate tax had already been dramatically lowered, corporate investments are not likely to pick up unless demand from the masses revives. I have doubts whether the budgetary measures can achieve that. To create more jobs, a lot more needs to be done in the rural areas—from building infrastructure to value addition in farm produce. The small/ medium industries will create jobs.

● **MAITREESH GHATAK:** No. One immediate indication of this is the Sensex falling by nearly a thousand points and the Nifty showing a similar trend, despite the abolishment of dividend distribution tax.

● **D.K. JOSHI:** Despite the fiscal stretch, budgetary allocation to capex increased, which will support growth. But infrastructure capex is expected to be lower as spending by central public sector undertakings (CPSUs) is declining due to the shrinking reliance on extra-budgetary resources. Given the sluggish domestic demand, private industrial investment is expected to stay muted. So a recovery of the overall capex will have to wait.

● **AJIT RANADE:** Private sector capital spending has been stagnant for quite some time. This is ironic in light of the jump in India's global ranking in Ease of Doing Business, from 142 to 63. The insolvency and bankruptcy law should have helped in restructuring and fresh capital infusion. It has shown some impact. The past five years have seen a strong inflow of foreign capital, but it's not clear how much went into greenfield and how much to buy distressed assets.

● **JAHANGIR AZIZ:** Corporate investment declined from its heydays before the global financial crisis. But almost all the decline took place in 2009-10. Over the past five years, it is investment in housing and SME investment that have plummeted.

● **N.R. BHANUMURTHY:** As the government had already reduced corporate income tax rates, other measures to encourage the private sector had been expected. The budget has removed the Dividend Distribution Tax (DDT)—a longstanding demand—while there is no change in long-term capital gains (LTCG) tax. The government has also taken several measures for MSMEs and start-ups. All these measures should help address most of the concerns of the private sector. However, financial frictions are restraining policy transmission. One way to address this could have been to stimulate savings. But unfortunately, most of the budgetary measures discourage savings.

Q. What are the budget's main virtues and/ or shortcomings?

Answer:

● **ASHOK GULATI:** The biggest virtue of the budget is that it does not contain anything too negative. The positive measures are more like baby steps. Given the slowdown, a bolder approach was needed. A shortcoming in the budget is the lack of transparency.

● **MAITREESH GHATAK:** The allocations for health, education, rural development and social welfare as well as the direction taken towards an inward-looking import substitution policy are disappointing. The fall in fertiliser subsidies and the marginal rise in petroleum subsidies are good signs, as is the commitment to privatisation.

● **D.K. JOSHI:** The virtues include the emphasis on sustainable growth and fiscal consolidation, and the focus on bond market development and attempts to attract foreign capital. The shortcomings are little support for the auto and housing sectors and minimal support for rural consumption.

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> **Maitreesh Ghatak, professor, LSE**

● **AJIT RANADE:** The positives are the stimulus inherent in personal income tax cuts. The removal of DDT is also welcome. The further opening up to foreign investors will help deepen the corporate bond markets. The 16-point action plan on agriculture shows that the government is giving it high priority, but most of the action-taking will be at the state level. However, there is nothing explicit for the auto sector, real estate and the NBFCs.

● **N.R. BHANUMURTHY:** The budget has continued to focus on agriculture, the rural sector and MSMEs, which are crucial for both demand generation and jobs. However, some more allocations to these sectors were expected. The budget also discusses some of the medium-terms issues related to infrastructural investments. The shortcomings include the deteriorating quality of expenditures, not addressing the decline in savings, increasing protectionism and the neglect of public sector banks.

Q. Is the fiscal math (fisc at 3.8 per cent of GDP) credible, even after accounting for extra-budget borrowings?

Answer:

● **ASHOK GULATI:** Not at all. The actual fiscal deficit, including borrowings of CPSUs, is around 5.5 per cent. Take the food subsidy and borrowings of the Food Corporation of India (FCI). Food subsidy in 2019-20 was provisioned at around Rs 1.84 lakh crore. The revised figure for FY20 is Rs 1.08 lakh crore and budgeted figure for FY21 is about Rs 1.15 lakh crore. No reforms have been carried out in grain management during FY20 or listed for FY21. The procurement prices keep increasing, the procurement of grains keeps going up, stocks keep bulging way above (3.5 times) the buffer stock norms, while issue prices and coverage under the National Food Security Act remain the same. How come food subsidy has sharply declined then? As on February 1, FCI's outstanding loans stood at Rs 2.53 lakh crore. If one adds this to the fiscal deficit, it will go up by at least one percentage point, and if one adds borrowings by other CPSUs, then it will hover around 5.5 per cent. I won't be surprised if it blows up to about 6 per cent of GDP, after accounting for borrowings by FCI and other CPSUs.

● **MAITREESH GHATAK:** Tax revenue in 2018-19 fell short by 10 per cent. Borrowings against the National Small Savings Fund nearly doubled. Another method used to make the deficit appear smaller is deferring payments to public sector units. These do not show up in the budget as expenses, but force these entities to borrow from the market, which makes the deficit a lot higher. The unpaid bill to FCI is around Rs 2 lakh crore while the fiscal deficit is Rs 7.6 lakh crore. Taking these into account, the fiscal deficit would be around 5 per cent.

● **D.K. JOSHI:** There were questions around the nominal growth rate assumptions for fiscal 2020. For fiscal 2021, the nominal GDP growth assumption of 10 per cent appears more realistic. The tax revenue target is ambitious, but achievable. The budget also attempts to come clean on extra-budgetary spending. However, aggressive targets for disinvestment and telecom revenues are potential sources of slippage on the non-tax revenue side.

● **AJIT RANADE:** The 3.8 per cent target depends on the ambitious assumption of getting Rs 2.1 lakh crore from disinvestment. The NDA government has been able to meet its disinvestment targets only twice in the past six years. This is not the same as influx of fresh private capital.

● **N.R. BHANUMURTHY:** The FRBM Act amended in 2018 is not credible. We have been arguing for reverting to the FRBM Act of 2003 that targets deficits (both fiscal and revenue) as well as public debt to achieve growth. Diluting the Act is only going to lead to inconsistency across these targets. More worrying is the deficit numbers for 2020-21. Despite no major structural reforms in the budget, the government invokes the escape clause and, at the same time, projects higher GDP growth.

Q. Is the new disinvestment target (Rs 2.1 lakh crore) realistic or wishful?

Answer:

ASHOK GULATI: If the past five and a half years are any indication, it looks like more a wish. But if the government is really focused on the economy and makes bold moves on privatisation, with trust in the markets and a smart disinvestment minister (like Arun Shourie), then nothing is impossible.

MAITREESH GHATAK: Since something as mundane as tax revenue projections went off the mark, it is hard to be too optimistic about disinvestment targets.

D.K. JOSHI: The disinvestment target is more than a three-fold jump from the Rs 65,000 crore mopped up in fiscal 2020, which itself was 38 per cent short of the Rs 1.05 lakh crore budgeted. The target this time hinges on strategic disinvestment in Air India, Bharat Petroleum and Life Insurance Corporation of India, among others. The NDA has been able to divest 86 per cent of the budgeted amount since fiscal 2015. It exceeded the targets in fiscal 2018 and 2019. But going by last year's performance, if these sales do not proceed as planned, we could see fiscal deficit thrown off by nearly 0.3 per cent of GDP in fiscal 2021.

AJIT RANADE: In the past six years, the government was able to achieve its disinvestment target only twice, that too using the 'left pocket to right pocket' approach, such as using ONGC cash reserves to buy other public sector shares. This year's target is highly ambitious and depends a lot on the success of the LIC IPO. A lot of political opposition is expected, but it is worth attempting and has been long overdue.

JAHANGIR AZIZ: The out-turn could still come under pressure, but most likely the government will resort to non-bond financing to cover the shortfall. The privatisation target for 2020-21 is ambitious. The government did not have much of a choice but to keep bond financing at a tolerable level while increasing spending to support growth.

N.R. BHANUMURTHY: I am not sure if the disinvestment targets are realistic. The budget says it could mobilise Rs 90,000 crore through stage sale in public sector entities and financial institutions. The rest of the Rs 1.2 lakh crore will come from other government undertakings. Going by recent achievements, this appears difficult. Also, the LIC stake sale negates the disinvestment idea. The government needed to divest only the loss-making entities. In the case of LIC, we are divesting an entity that has been the main rescuer of governments for most of their EBR and is not loss-making. It is like selling the golden hen. But this also indicates the fiscal distress faced by the government.

"Only loss-making entities needed to be divested. The LIC stake sale indicates the fiscal distress"

N.R. Bhanumurthy, Professor, NIPFP

Q. How would you rate this budget on a scale of 10?

Answer:

ASHOK GULATI: Six out of ten (6/10).

MAITREESH GHATAK: As someone who has to grade examination scripts and essays as part of my job as a professor in a university, I would pass grading the budget. The reason is the benchmark is not obvious. Is it how, say, Dr Manmohan Singh would have performed in the current economic situation, or how he did in 1991? It is not an impressive budget by any means even when you take the difficult economic circumstances into account. But I think it will be unfair to call it a disastrous budget either.

AJIT RANADE: Six out of ten (6/10).

N.R. BHANUMURTHY: Given the context and the constraints that the Indian economy is facing right now, the space for government was indeed limited. Hence, I would restrain from rating the budget.