

Fiscal Prudence and Incremental Resource Allocation: Macroeconomic Perspectives of the Union Budget 2016-17



The Union Budget for the year 2016-17 was expected to convey a vision of the Government's economic policy addressing the challenges faced by the country and act as a catalyst for growth. The budget gave a direction towards fiscal prudence, which will enhance the credibility of the Government's policy and increase the investors' trust. Reviving private investment in the economy, however, will depend upon many other factors including monetary policy management and capacity of the financial market. The Government made its priorities clear in the resource allocation, emphasising on rural and infrastructure sectors. Given the resources and the trade-offs due to competing demands, the resource allocation in the budget was incremental with a political message.

Introduction

The perspective provided by the Economic Survey presented earlier regarding the economic problems and the need for a modern economic management, heightened the hopes for an innovative approach.



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The debate regarding public investment-led growth process by easing up on the fiscal consolidation as compared to adopting fiscal prudence, as played out in the run-up to the Union Budget, pointed out to the difficulties in providing positive signals to revive the private investment while pursuing the fiscal consolidation.

An annual budget may not be the right instrument to provide comprehensive reform plans for the future. A conventional budget, typically, pays more attention to resource allocation based on the economic and political agenda of the Government and financial

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aspects in terms of control over the use of public resources. However, in India, the presentation of the annual budget generates copious interest in analysing the Government's policy agenda and it is treated as an instrument to indicate reform plans. Balancing the future policy options regarding an expansionist fiscal stance through higher public investment to that of the fiscal credibility is not a one-stop measure. Nevertheless, due to concerns for growth prospects, the ensuing budget was considered as an important instrument to give directions regarding the policy choices of the Government.

Macroeconomic Perspective

In the prevalent gloomy international macroeconomic scenario, India has registered a healthy economic growth in 2015-16 at 7.6 percent over a 7.2 percent in 2014-15. The country's growth story based on the strength of domestic demand remained consistent with other macroeconomic parameters like inflation, fiscal deficit and current account balance. The wholesale price index (WPI) has been in negative for more than a year and the consumer price index (CPI) has shown a declining trend, which will form the basis for taking monetary policy decisions. Despite several deferments, the Government has shown fiscal restraint by achieving the fiscal targets set under the FRBM Act.

Going ahead from here is fraught with many difficulties. The sluggish demand due to weak global macroeconomic situation and low commodity prices has adversely affected India's exports. During the current financial year, India's exports declined by 17.6 percent. The current account deficit, however, remained moderate due to decline in imports driven by reduced prices of crude oil. The droughts in the last two years resulted in lower growth for the agriculture, which increased the rural distress. The saving and investment rates have shown a declining trend and the rupee has depreciated. The gross domestic savings rate in the economy declined by 1.6 percentage points of the GDP from 2011-12 to 2014-15, mainly due to decline in household savings. The private investment climate has not remained conducive to the future growth process.

Although, a significant feature of public finance was achievement of the fiscal targets set under the FRBM Act, the fiscal challenges remained onerous. The borrowing requirement to meet the combined fiscal deficits and the rise in salary spending due to pay revisions was expected to increase interest

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payment, which would eat up a substantial portion of resources. At the Union level, the interest payment alone has accounted for about 40 percent of net revenue in 2014-15 and budgeted at about 50 percent in 2015-16. The subsidy Bill was not expected to decline further as was the case in 2015-16 due to the advantage of steep decline in oil prices. The growing tax devolution following the recommendations of the 14th Finance Commission was set to shrink the revenue envelope available to the Central Government. The deficit induced borrowing program shrinks the productive expenditure and the loanable funds for private investors, which jeopardises the crowding in thesis given that the household sector's financial savings have not seen a significant rise.

The budget was not all about investment and growth. Providing for the ongoing schemes, MGNREGA, and social sector schemes were also priorities. The policy objectives need to be aligned with the requirement of the financial resources and the way to raise them. Given the macroeconomic environment and fiscal situation, it was a tough task for the Government to provide signals to revive the private investment while pursuing the fiscal consolidation. The need for focusing on infrastructure, rural sector, particularly agriculture and irrigation and restoring the health of the banking system was undeniable. Absence of private investment in highways and roads makes it imperative to think about innovative financing schemes and revival of PPPs. The health of the banking sector is a

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matter of concern due to increasing non-performing assets and there is a need to look at this crucial sector.

Union Budget Proposals

One of the important budget decisions for the year 2016-17 was to stick to fiscal deficit target of 3.5 percent of GDP conforming to the FRBM Act despite the appeals to dilute the targets and increase the public investment. The Government also maintained the fiscal deficit target at 3.9 percent in RE 2015-16 as required by the Act. The compliance with the FRBM Act was done by reducing the revenue and primary defect, thus improving the quality of fiscal deficit. This is a powerful signal to contain the government borrowing and to the RBI to moderate interest rate to revive the private investment. Although sticking to the fiscal rules improves the credibility of the Government policy, there are still some doubts whether this will increase the space for financial market to increase the lending. The Government has also proposed several special purpose vehicles to augment public investment for irrigation, railways and roads. To what extent the financial markets would be able cope up with these borrowing programs is not clear.

Focus on rural economy in the budget was not only to address the rural distress reeling with debilitating effects of two back to back bad monsoons, but also to act as a channel to improve growth through increased rural demand. Doubling the farmers' income by 2022 is an ambitious target though. The spending decisions like high allocations of ₹38,500 crore to MGNREGS, creation of a long term irrigation fund under NABARD at ₹20,000 crore allocation and a program with ₹6,000 crore allocation for better ground water management are the vehicles for this purpose. The program to fast track 23 major irrigation projects and bring an additional 28.5 lakh hectares land under irrigation is also important in this context. High allocation to rural sector and ₹2.87 lakh crore grants to rural local bodies based on 14th FC recommendations are also

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seen as a major thrust given in the budget for rural areas. The proposal to create national agricultural market is aimed at providing remunerative prices to the farmers. However, the implementation of the projects in these sectors remains the Achilles' heel in India mired in capacity constraints, inadequate project management problems and legal hurdles.

Road infrastructure, another focus area in the budget, aims at creating multiplier effect on linked sectors- cement and steel, automobiles, and provide for faster movement of goods to facilitate growth process. The government has set a target of 2019 for full connectivity to all eligible habitations through road connectivity. Budget allocation of ₹27,000 crore including State share for village roads, ₹55,000 crore for road construction with National Highways Authority of India (NHAI), which is expected to add another ₹15,000 crore via bonds, makes the total spending in road transport to ₹97,000 crore. The proposed investment by the railways is further expected to spur the growth process. While the budgeted capital outlay for the railways has been maintained at ₹40,000 crore, the railways capital investment plan is sought to be met from borrowed funds.

The Government has been grappling with the problem of stressed assets in public sector banks (PSBs) in recent years. A program called Indra Dhanush was launched last year to address the NPAs of the public sector banks. In the budget 2016-17, a provision of ₹25,000 crore for bank recapitalisation was made for the resolution of the stressed assets problem. However, larger questions remain unanswered as to how the banks continue to pile up such NPAs and why the Government has to provide from taxpayer money to make the PSBs viable.

Looking at the receipt side, to fund the spending plan, the revenue receipts constitutes about 70 percent of the resource envelope and capital receipts including the borrowings accounting for about 30 percent. While the revenue receipt is projected to grow at 14.17 percent over the 2015-16 RE, the tax revenue is set to grow at 11.25 percent. This

growth, with an implicit buoyancy of 1.06 percent, should be considered as realistic. However, the buoyancy assumed for income tax at 1.64 percent seems ambitious. The projected growth rate for non-tax revenue at 24.88 percent and for non-debt capital receipts (leaving out the recoveries) at about 123 percent seems problematic. The high growth rate assumed for non-tax revenue is based on the higher expected income from spectrum sale in the communication sector at about ₹99,000 crore. This looks unrealistic, as the income from this sector was ₹56,000 crore in 2015-16. Similarly, higher expectations from the non-debt capital receipts is based on income from disinvestment proceeds, in which the Government could not manage to match the projections last year. Thus, the projection for both the non-tax revenue and non-debt capital receipts may not be achievable and has the potential to undermine the fiscal outcomes.

The spending numbers relative to GDP in the budget does not show a rise responding to the infrastructure focus in 'Make in India' campaign. The capital expenditure as percentage to GDP has actually gone down to 1.64 percent as compared to the 2015-16 RE level of 1.75 percent. The plan expenditure on capital side has remained below 1 percent in this year's budget. The squeeze on capital expenditure seems to be due to large committed revenue expenditure, in which the interest payment alone accounts for about 36 percent of revenue receipts. The impact of pay revision, OROP and total pension Bill limited the scope for increasing the capital outlay. It will be difficult even to sustain this level of capital outlay if the projections relating to spectrum sale and disinvestment do not materialise. The push given to infrastructure, national highways and rural roads depends upon the funds raised through market and leveraging through PPPs in

addition to the budget support. There was not much change in the revenue expenditure as percentage to GDP, which remained at 11.49 percent as compared to the 2015-16 RE level of 11.41 percent. The priorities have, however, changed, showing a resource trade-off within the available resources.

It was expected that the budget decisions would revolve round taking tough choices of controlling spending and making additional efforts to raise revenues to boost the capital expenditure. While the Government will continue with the direct benefit transfers (DBT), hopefully fertiliser subsidy coming into this in the future, there was not much effort in compressing the subsidies in this year's budget. The subsidy budgeted at ₹2.5 lakh crore cuts into the resource available for capital investment. The food and fertiliser subsidy continues to get patronage.

The budget has suggested many welcome measures such as reducing discretion and litigation for simplifying the tax administration. Establishing dispute resolution panel, limiting power of income tax department to appeal against the panel directives, enhancing audit threshold, and application for sunset clause tax incentives are positive changes. However, the proposals to increase custom duties on many items, to increase securities transaction tax and to levy dividend tax in the hands of rich tax payers do not seem to simplify the tax system. The Government continues with its practice of adding cesses and surcharges for additional resource mobilisation purpose.

The simplification of the tax system to establish a friendlier and accountable tax administration was anticipated. Particularly, the simplification and rationalisation of indirect taxes was suggested keeping the eventual introduction of GST in consideration. Although the introduction of the GST will depend on the passage of the Constitutional Amendment Bill, the budget has not suggested any measure to facilitate the transition to the GST regime.

Some of the budget proposals from the expenditure management point of view show the intents of the Government in establishing new institutional framework. The decision to do away with plan and non-plan distinction from the expenditure classification will lead to establish a medium term framework, which is required after the decision, was taken to abolish the Planning Commission. A medium term fiscal framework needs a robust macro-fiscal framework specifying the

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resource envelope to determine the sector ceilings and bottom-up prioritised sector frameworks on program formulation. Expenditure management is a complex process; the building blocks need to be put in place to ensure value for money from the use of public resources. The budget proposal to set a sunset date and outcome report for schemes will be helpful in program management for the spending departments.

While the Government adhered to the fiscal targets under the FRBM targets, the budget proposed to review the Act to revise the fiscal consolidation framework. The FRBM Act remained pivotal in the fiscal management system of the government. However, concerns were raised from time to time regarding the fixed fiscal targets without factoring the economic situations. Since the slowdown started in 2008-09, the Government postponed the Act in 2009-10 and deferred the fiscal targets and time lines many a times due to economic problems. It is important to calibrate the fiscal consolidation process taking into account the structural deficit and the countercyclical fiscal response of the Government during the periods of growth and recession.

Concluding Remarks

The fiscal consolidation and public investment to serve as a springboard for growth at the same time was too ambitious agenda to seek from an annual budget when the growth prospect is not very positive. Indeed the budget for the year 2016-17 gave a direction towards fiscal prudence due to its adherence to fiscal commitments. The fiscal prudence will increase the credibility of the Government's policy and increase the investors' trust. Reviving private investment in the economy, however, will depend upon many other factors including monetary policy management and capacity of the financial market. The government made its priorities clear in the resource allocation emphasising on rural and infrastructure sectors. Generally, budgets involve resource trade-offs due to competing demands and limited availability of resources. Given the revenue projection based on the assumptions regarding the GDP growth and the borrowing program limited by the fiscal deficit, the resource allocation in the budget was incremental with a political message. ■

