COLUMN

Predictable but unrealistic

The expenditure proposals of the budget were predictable, and its revenue projections quite unrealistic. The one item that was not predictable, but on which there was much debate, was whether the fiscal deficit target of 3.5% of gross domestic product (GDP) for 2016-17 would be breached. Finance minister Arun Jaitley has maintained the target, but also announced a review of the Fiscal Responsibility and Budget Management (FRBM) Act, a clever balancing act between fiscal hawks and demand revival enthusiasts.

The proposed review is most welcome because crudely fixing a fiscal deficit target to GDP is irrational. The fiscal stance is supposed to be counter-cyclical, and coordinated with the monetary policy stance, as the finance minister mentioned. Fixing the deficit as a GDP ratio makes it pro-cyclical. It shoots up during high growth, but the increase slows down during low growth, just the opposite of its desired movement. Global best practice targets the structural deficit, aligned with normal growth. Let's now turn to the revenue and expenditure projections underlying the deficit target.

Tax revenue is assumed to grow 11.7%. The implicit overall tax buoyancy of 1.06% is quite reasonable though the assumed 1.64% buoyancy for income tax seems too optimistic. Unfortunately, the assumptions underlying the non-tax revenue projections and non-debt capital receipts are quite unrealistic, and will undermine the deficit target. The largest component under non-tax revenue are receipts from 'other non-tax revenues'. They are assumed to grow by a whopping 46% from ₹112,937 crore in 2015-16 to ₹165,320 crore in 2016-17! Of this, the main component are receipts from spectrum sale in the communications sector, amounting to approximately ₹99,000 crore, compared to only about ₹56,000 crore last year. Quite unrealistic.

Similarly, 'Miscellaneous Capital Receipts' are expected to grow by a breathtaking 123%, from only ₹25,312 crore last year to ₹56,000 crore this year. That consists of ₹36,000 crore from disinvestment, which raised only ₹25,312 crore against a target of ₹41,000 crore last year; and ₹20,000 crore from 'strategic disinvestment'. Last year the amount raised from this was zero, compared to a target of ₹28,500 crore.

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Are the mandarins in the finance ministry expecting a miraculous recovery in the stock market to deliver these numbers?

Turning to the expenditure side, this government is known for its focus on infrastructure. Hence it is somewhat underwhelming to find that total plan capital expenditure is down to less than 1% of GDP in the budget. Presumably, this reflects the squeeze in the fiscal space because of committed expenditure on the revenue account. Total interest payments, which eat up nearly 36% of revenue receipts, are projected to grow at over 11%. With One Rank-One Pension and 7th Pay Commission recommendations, revenue expenditure on defence services and police will grow by 13.6% and 13.5% respectively. The pension bill will grow by nearly 29%.

Within capital expenditure, there is the expected push to key infrastructure. Thus, the largest component, transport and communications, accounting for 34.5% of plan outlay, is projected to grow by 27% to ₹243,680 crore. The largest component in this are roads, national highways and rural roads. But also included here are ports, airports, and communications. In addition to this budget support, the government will also raise funds from the market through National Highways Authority of India bonds, as well as leveraging investment through public private partnerships (PPP). These investments, and investments proposed in the railway budget, are quite critical to kick-starting the investment cycle and need to be watched closely.

In the rural sector, 'irrigation and flood control' will account for only 0.14% of the plan outlay, and 'agriculture and allied activities' for 2.75%. Rural development will account for a mere 0.39%. Given all the hype about the focus on the farmer, this is disappointing.

Social service spending will also remain very modest, as expected, accounting for only 14% of the plan outlay. General education, the foundation on which the government could grow skill formation and productive employment, will account for only an appalling 1.4%. The allocation for 'medical and public health' is no better at 1.4%. And the allocation for 'water supply and sanitation' has virtually disappeared at only 0.01% of the plan outlay.

The low allocation for agriculture, rural sector and social sectors, though predictable, is disappointing. The government could of course claim, with some justification, that these are state subjects. Following the 14th Finance Commission award, it is for the states to focus on these activities. It could also claim that, given the extremely challenging external environment, its focus on infrastructure to revive the domestic investment cycle is justified. But on what grounds can it justify the quite unrealistic revenue projections, especially for non-tax revenue, that will certainly undermine its 3.5% fiscal deficit target?

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