Budget 2018: The reality behind the rhetoric

The sad experience of several Asian countries such as China, Indonesia and the Philippines, which introduced social insurance for private healthcare provisions at low levels of per capita income, is a dire warning

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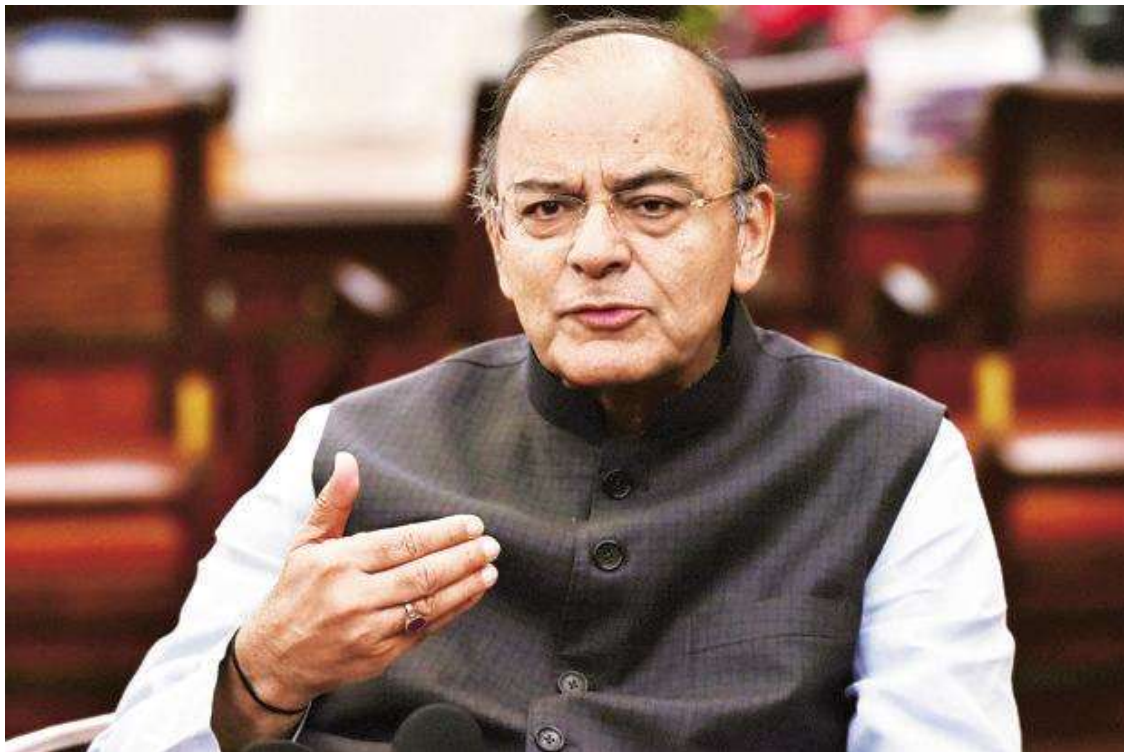

Finance minister Arun Jaitley. This shocking return to protectionism after decades of trade-liberalizing reform is the most disappointing aspect of Budget 2018. Photo: PTI

This was Union finance minister Arun Jaitley's last full budget before the next general election. Headline-grabbing announcements were particularly important. Hence, a close scrutiny of the actual numbers is necessary, separating rhetoric from reality, to arrive at a sober assessment of the budget.

On the macro fiscal policy stance, it is a pity the government overshot its fiscal deficit target for 2017-18, indicating a lack of commitment to fiscal consolidation. Quarterly gross domestic product (GDP) data shows that declining growth turned around from the second quarter of FY18, with growth exceeding 7% during the second half of the year. The decline in

gross fixed capital formation growth has also turned around, indicating that the investment cycle is finally recovering. All projections indicate that growth in 2018-19 will exceed 7%. There was no case therefore for excessive pump-priming from a counter-cyclical fiscal policy perspective, especially when there is increasing risk of imported inflation because of hardening oil prices.

The fiscal slippage was not on account of excessive spending. Total expenditure rose by 10.1%, less than the nominal GDP growth rate of 11.5% indicated in the budget. It was also in line with the original budget target barring the set-aside for goods and services tax (GST) compensation as explained below. The excess deficit was entirely on account of a shortfall in revenue. The roll-out of the GST was a major reform. It was bound to be disruptive in the short run, especially coming soon after the demonetization shock of November 2016. Hence, overshooting the fiscal deficit target on this account would be quite understandable. But this is not the case.

Central government tax revenue in FY18, net of states' share, actually exceeded the budget estimate by over Rs42,500 crore, mostly on account of buoyant direct tax collections. Indirect taxes too seem to have grown by 8.7%. However, this does not net out the set-aside of Rs60,500 for the GST compensation fund, as was pointed out to me by my colleague Kavita Rao. Net of this component, the shortfall in tax revenue accounts for excess deficit to the tune of about Rs18,000 crore.

However, there was a shortfall of nearly Rs53,000 crore in non-tax revenue, which primarily accounts for the excess deficit. The major shortfall here was in dividends and profits of public enterprises, including banks, and transfer of surpluses from the Reserve Bank of India (RBI). There was a significant element of discretion here because the amounts of transferred profits and RBI surpluses is negotiated between these institutions and the government. Similar discretion was exercised in excess borrowing of over Rs100,000 crore, mainly through short-term treasury bills. Clearly, exceeding the fiscal deficit target for FY18 was a very deliberate policy choice.

Against that background, loosening the fiscal deficit target for FY19 to 3.3% of GDP, even higher than the FY18 target of 3.2%, indicates that the glide path towards fiscal consolidation has been deliberately reversed. Such

pump-priming when the economy is already on a growth path in excess of 7% doesn’t make much economic sense. However, it does make good political sense for a ruling party getting organized for general elections just over a year down the road, with several state elections along the way. If inflation remains subdued, pump-priming higher growth would be great. If hardening oil prices do lead to a spike in inflation, high inflation along with high growth is still preferable politically, compared to high inflation combined with lower growth.

In his direct tax proposals, Jaitley stated that he is extending the reduced 25% corporate tax rate to businesses with turnover up to Rs250 crore, which will cover 99% of businesses filing returns. This move is at odds with his observation that on average, businesses pay only Rs25,753 per individual business taxpayer while the salaried taxpayer pays Rs76,306 per individual, because the latter will continue to be taxed at 30%.

A much-discussed direct tax measure is the introduction of a long-term capital gains tax, or LTCG tax, of 10%. With capital gains in the equity market hitherto untaxed, taxpayers who became very wealthy through capital gains paid no tax on those gains. The negative market reaction notwithstanding, the finance minister should be applauded for this move. However, capital gains being rewards for bearing risk, it is worth asking whether capital gains and losses should be treated symmetrically and, if so, how.

Among direct tax administration measures, the roll-out of E-assessment after pretesting the system in some 102 cities is significant. In time, it will considerably improve efficiency and transparency in direct tax administration.

With much of domestic indirect taxation beyond the purview of the central budget following the roll-out of GST, major indirect tax proposals are now limited to customs duties. For years, there has been a gradual movement, even if only partially successful, towards lower and more uniform customs duty rates. The move in this budget is in the opposite direction. For the express purpose of domestic protection to push Make In India, duty rates have been raised for around 100 products spread across 50 broad groups. This shocking return to protectionism after decades of trade-liberalizing reform is the most disappointing aspect of the present budget in my view. It

is particularly jarring coming so soon after Prime Minister Narendra Modi's strong pitch for free and open trade in his keynote address at Davos.

Coming to expenditure proposals, I limit my remarks to a few particularly significant proposals relating to agriculture, health services and bank recapitalisation.

In agriculture, minimum support prices (MSP) are announced for a whole range of crops but supported through procurement only for wheat and rice. With persisting farmer distress, the announcement that MSPs for other crops would be ensured either through direct purchase or other means received much attention. However, this budget proposal remains unfunded so far, barring a token provision of Rs200 crore. NITI Aayog has been asked to work out a mechanism for implementing this policy.

More significant in my view is the proposal to create an upgraded network of 22,000 rural *haats* (Gramin Agricultural Markets or GrAMs), electronically linked through e-NAM and exempted from Agricultural Produce Market Committee (APMC) regulations. The standard narrative of conflict between farmer interests and consumers over food prices loses sight of the trader lodged between the two. It is the traders who squeeze the hapless farmers and appropriate the surplus when food prices rise. Their market power derives from controlling the APMC-regulated markets. Freeing millions of farmers, most of them small and marginal, from these APMC regulated markets would be liberating. However, it is not clear that the proposed GrAM network is being adequately funded.

Note in this context that despite all the rhetorical concern for the farmer, budget allocation for the rural sector, which accounts for some 60% of our population, is just 12% of total expenditure. Computed on a net basis as per the annual financial statement, the combined allocation for agriculture, allied activities and rural development amounts to about Rs3 trillion out of a total budget expenditure of about Rs24.4 trillion.

The National Health Protection Scheme (NHPS) became a headline item in the budget. The idea is to publicly pay the insurance premium for private insurance, covering privately provided secondary and tertiary healthcare for poor and vulnerable families. The goal is to cover 100 million families, or 500 million people, for annual claims up to Rs5 lakh per family. At

present it is only an other ambitious but unfunded goal. NITI Aayog has been asked to work out the actual scheme, which could possibly be ready by October. Meanwhile, an initial allocation of Rs2,000 crore has been earmarked in the budget to get the scheme going.

The ultimate cost of the scheme will depend on the healthcare services to be covered, the actuarial cost of insurance covering 100 million families for these services, and the deals that are negotiated with private insurers and health service providers. The sad experience of several Asian countries like Korea, China, Indonesia and the Philippines which introduced social insurance for private health care provisions at low levels of per capita income, is a dire warning. Typically, programme expenditure spun out of control, service coverage was cut down, and people were left to fend for themselves as the out-of-pocket (OOP) expenses for uncovered services soared. There was a sharp spike in health status inequality.

In India, the share of OOP expense is very high, mostly spent on outpatient services and medicines. NHPS will not cover such primary healthcare. A far more important budget announcement is the proposed network of 150,000 rural care centres for providing comprehensive primary care. This could be an excellent programme if properly funded. The Rs1,200 crore provided so far is just a pittance.

Finally, we have the recapitalization scheme for public sector banks. In FY18, Rs10,000 crore was provided through the budget and another Rs80,000 crore through bank recapitalization bonds. Another Rs65,000 crore has now been provided through similar bonds, bringing the total to Rs1.55 trillion. Recapitalization by itself is neither banking reform nor a solution to the non-performing loan (NPL) problem. Resolution of NPLs is being addressed separately through the bankruptcy code. But recapitalization bonds enable banks to use their loan book to recapitalize themselves via the government. It can revive the credit cycle which lay at the heart of India's growth slowdown of the past couple of years. At the same time, with the new asset offsetting the new debt liability, the integrity of the sovereign balance sheet remains unimpaired.

From the growth perspective, this is probably the best move in Jaitley's budget of ambitious but unfunded goals.

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Comments are welcome at theirview@livemint.com

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