Budget FY16

# Govt gets its priorities right

## Attaining high growth led by public investment, without compromising equity, is a good strategy

SUDIPTO MUNDLE

**With private investment still bearish, revival of the growth cycle is critically dependent on the rise in public investment**

Apart from the finances of the Centre, Budget FY16 was expected to also spell out the economic vision of the new government, and its roadmap for translating that vision into an action programme. The big push seen in some areas, slowdown in others, and even back-tracking in some, gives us a picture of that roadmap.

On the revenue-side, some immediate measures have been combined with credible commitment to reforms starting next year. Among the immediate measures, the wealth tax that yielded little has been replaced by a 2% surcharge on the 'super rich', estimated to yield ₹9,000 crore. Several relief measures have also been introduced for middle-income taxpayers. Subsuming the education cess, the general central excise duty rate and service tax rate have been consolidated at 12.5% and 14%, respectively. The clean energy cess has been doubled and a provision made for a Swachh Bharat cess of 2% on services.

Projections for the major items of non-tax revenue, i.e. dividends and profits of PSUs, public sector banks and RBI, and receipts from spectrum sale are realistic as is the gross tax revenue estimate of ₹14,49,490 crore, implying a tax buoyancy of 1.37. However, the projected receipt from disinvestment in PSUs, at ₹69,500 crore, is more than double the amount of ₹31,350 achieved last year. With a pipeline of only about ₹30,000 crore reportedly available, this could leave a large hole in the Budget.

Among the promised tax reforms, the most important one is the introduction of the goods and services tax (GST) from April 1, 2016. It will make India a unified common market, eliminate cascading, and vastly simplify the indirect tax regime. This ambitious goal may be achieved this time because finance minister Arun Jaitley has resolved the vexatious issue of compensation for foregone central excise revenue. The required legislative action is being launched. The IT platform and other administrative preparations to introduce GST are also on track. Another promised reform is the reduction of the corporate tax rate from 30% to 25% over four years starting from FY16, along with the elimination of exemptions and concessions, i.e. tax expenditures, which translate to an effective corporate tax rate of 23%. Tax expenditures are the worst distortions of our tax system, conservatively estimated as causing a revenue loss of nearly ₹6 lakh crore or over 4% of the GDP. They also lead to much litigation. So, the move is welcome. However, it is not clear how far the government will go, since some fresh exemptions and concessions have been introduced in this Budget.

Other key reforms include legislation to rein in the growth of black money, postponing application of the general anti-avoidance rules to 2017, and the simplification of tax procedures to improve the ease of doing business in India. However, the government has also unfortunately decided to abandon the aim of a direct taxes code (DTC). Only tax lawyers and accountants will welcome this as they would lose much business if we had a simplified DTC.

Turning to the expenditure proposals, these quite dramatically reflect the priorities of the government. They are best captured in the central Plan outlay. The allocation for transport, including for rural roads, is being raised by a massive 82% to ₹1,93,417 crore. It accounts for the largest share at over 33%, followed by energy at 29%. Together with industry and minerals, communications and science, technology and environment, the group of infrastructure and manufacturing sectors account for over 75% of total central Plan outlay. Adding to it, non-Plan capital spending on defence and internal security services, this government's focus on public-investment-led growth is quite clear.

In contrast, agriculture and allied activities, irrigation and flood control together get a mere 2%. This may be attributed to the rebalancing of the Union spending in line with the Constitutional roles of different tiers of the government, given agriculture being a state subject. However, inclusive Plan spending on education, health and anti-poverty programmes such as the MGNREGA, which together account for about 15% of the central Plan outlay, have been expanded by over 27%. The food subsidy has also been preserved and modestly increased. The stated aim is not to cut all subsidies but better target them and cut leakages. Increasing recourse in direct benefit transfers using the Jan-Dhan Yojana-Aadhaar-mobile banking trinity is the chosen strategy for this. Therefore, while public-investment-led growth is clearly the government's top priority, it is also investing in inclusive growth.

The third dimension of this Budget—in some ways also the most significant—is its adoption of the recommendations of the 14th Finance Commission, which I discussed in an earlier column (*goo.gl/Uc5WIw*, "Balancing fiscal space", *FE*). Suffice it to say that there is no significant change in the share of the Union and the states in the shareable pool of taxes. However, the reduction in the share of tied, often conditional, Union grants in favour of mandatory, untied transfers greatly enhances the flexibility and autonomy of the states in pursuing their own priorities, changing the quality of Union-state fiscal relations. The Finance Commission had also proposed a new institution of cooperative federalism, including representatives of the Union, states and domain experts, to oversee discretionary transfers. This has not been done. Perhaps the government has not had the time to deliberate on this, or it has decided to entrust this role to the Niti Aayog, or it has decided not to walk the talk on cooperative federalism beyond a point. Let's hope it is not the last of the three.

Finally, how will all this comes together for fiscal consolidation and fiscal-monetary policy coordination between the finance ministry and RBI? The new monetary policy framework agreement signed by the Union government and RBI is a major landmark in this, supported by the announced setting up of a Public Debt Management Agency and other financial market reforms. For FY16, the government has relaxed the earlier FRBM fiscal deficit target of 3.6% to 3.9%, and it has shifted the date for reaching the final target of 3% to FY18, giving itself more headroom and time for fiscal consolidation. Fiscal conservatives would disapprove. With the Budget projecting growth of around 8.5% in FY16, why the need for postponing fiscal consolidation? However, with private investment still bearish, revival of the growth cycle is critically dependent on the push of public investment. Moreover, the latest 25 bps cut in the policy rate suggests RBI expects inflation to remain moderate. Oil and other commodity prices remain subdued. The current account deficit has shrunk. Given this benign environment, the government has sought some extra fiscal headroom to achieve its strategy of high growth led by public investment, without compromising equity spending on food subsidy, MGNREGA, education, health, etc. I would not complain too much.

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