The budget is over; the tough part starts now

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The Centre hopes to finance its big boost of capital expenditure partly by higher receipts, especially higher tax revenues, and partly by compressingrevenue expenditure

The 2022-23 budget has been prepared under very challenging conditions. Growth of around 9% in 2021-22 notwithstanding, our economy's recovery from the covid shock remains fragile, inducing the Monetary Policy Committee to maintain its accommodative monetary-policy stance and existing policy interest rates. Data on employment, consumption and wealth all point to a sharp increase ininequality and distress among workers and the unorganized-sector self-employed. Inflationary pressures have persisted due to supply chain disruptions and rising oil prices. The Consumer Price Index inflation rate has remained within the Reserve Bank of India's target band at 5.6%, but food inflation has risen over 9% and wholesale price inflation has been even higher at 13.6%. Further, even before therecent post-budget spike, bond yields had been elevated. Finally, an expected rise in US interest rates is leading to a net outflow of foreign portfolio investment (FPI) and foreign exchange. Faced with challenging conditions, Finance Minister Nirmala Sitharaman has bet on growth to ease all other pressures. The hallmark of this budget is growth led by a massive increase in capital expenditure (capex).

After correcting for the capital infusion of ₹51,971 crore in Air India, capex is projected to increase from ₹5.5 trillion in the revised estimate (RE) for 2021-22 to ₹7.5 trillion in the budget estimate (BE) for 2022-23, a breathtaking 36%

annual increase on top of the 35%jump in 2021-22. Much of this planned increase is for infrastructure.

That huge capex increase is planned along with the process of fiscal consolidation initiated last year. The fiscal deficit was sharply compressed from a pandemic-driven high of 9.2% of gross domestic product (GDP) in 2020-21 to 6.9% in 2021-22 (RE), and is to be reduced further to 6.4% in 2022-23. The consolidation in 2021-22 was premature, but it is necessary now, given the persisting inflationary pressures, elevated bond yields and net FPI outflows. The planned 0.5% of GDP reduction in the fiscal deficit is also realistic and on track to achieve a target of 4.5% by 2025-26 (as announced last year). How will the Centre's big boost of capex be financed, given the emphasis on deficit reduction? It will be financed partly by higher receipts, especially higher tax revenues, and partlyby compressing revenue expenditure.

On the receipts side, tax revenue and the Centre's share are both estimated to go up by 9.6%. The implied buoyancy of 8.7%, corresponding to an assumed nominal GDP growth of 11.1%, is conservative. The modest tax revenue projection is mainly on account ofreductions of excise duty on petroleum products. However, GST has now stabilized and Central GST is projected to increase by 15.8 % in 2022-23. Direct taxes are also projected to grow by a high 13.6%, thanks to several administrative and legal rationalization measures. Overall, the Centre's share of tax revenue, which accounts for about 85% of total non-debt receipts, will have grown by nearly 43% compared to a pre-pandemic level of ₹13.6 trillion in 2019-20, an impressive achievement.

Non-tax revenues and their main component, the dividends and surpluses of public enterprises, are expected to decline for a third year insuccession. This is mainly on account of a lower provision for dividends from RBI. Non-debt capital receipts are also budgeted to fall by29.7%, mainly on account of a 16.7% projected decline in disinvestment receipts. This has been widely criticized, but instead of chasingunrealistic targets, it's better to set a modest but realistic target.

The second means of financing the large jump in capex within a limited fiscal deficit cap is compression of revenue expenditure.

Revenue expenditure is almost flat at ₹31.9 trillion in 2022-23, compared to ₹31.7 trillion in 2021-22, implying a substantial decrease in real terms. Squeezed between this cap on total revenue expenditure and the large share of committed expenditures like interest payments, wages and salaries, pensions, etc, the axe has fallen on discretionary social protection programmes like the food subsidy and income support for farmers (PM-Kisan) and rural workers (MNREGA). For all of them, allocations in 2022-23 are less than in 2021-22. Thisseems remarkably uncaring at a time when there is so much evidence of widespread distress. It is also inconsistent with the explicit budget strategy of maximizing the multiplier effect of government expenditure on output and employment. Capex indeed has a stronger multiplier effect than revenue expenditure. Yet, programmes like MNREGA, PM-Kisan and food subsidies meant for the poor have an even higher multiplier effect because the consumption propensity of the poorest is the highest. A slightly smaller increase in capex couldhave avoided these cuts in social protection schemes. The budget's modest nominal increase in health expenditure, implying a decrease in real terms, is also disappointing, as we are yet to emerge from the pandemic.

Despite fiscal consolidation, the deficit will still be very high. Gross market borrowings, the main source of financing the deficit, will bethe highest ever, at nearly ₹15 trillion. This raises worries about the impact of such a large borrowing programme on economic and financial stability. It will increase inflationary pressures, while the yield on dated securities had already spiked post-budget. Net FPI andforeign-exchange outflows are also gathering momentum. The finance ministry and RBI can expect tough days ahead.

These are the author's personal views.

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