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India's Budget and the macro puzzle

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The Budget deals with allocating money towards areas where the government thinks it is essential to spend, and finding out ways such as taxes, to finance it. The government primarily requires money to spend on social infrastructure (such as schools, hospitals, water, sanitation, etc.), physical infrastructure (such as railways, roads, airports, etc.) and transferring funds to the poor and the deprived, so that distribution of income becomes more equal.

But, how does one say whether a budget is good or bad? The general assumptions underlying a good budget are: it contains the fiscal deficit, carries on with the necessary reforms, and give incentives to consumers and business.

It is to be noted that India is the only large economy in the world which is growing at a 6.5 plus %, and yet this growth rate is not supported by some fundamental micro and macro-economic indicators. Importantly, in this phase of de-globalization (read, the Trump factor), and disruption post-demonetisation, it will be a miracle if India can achieve a 7% growth. Market pundits and economists were therefore looking for action plan from the Finance Minister (FM) that will sustain economic growth in a more equitable fashion.

To put things in perspective, post-demonetisation common man in the street, and small and medium size entrepreneurs will vouch for a fall in overall demand. There has been a fall in car, two-wheeler, and cement production. In fact, service pmi (purchasing managers' index) tracking sales, employment, inventories, and price data of private service sector companies has shown a sharp decline in recent months – 46.8 as oppose to an average of 51.5 over last five years.

Service is the most important sector, contributing to 67% of India's national income. The pessimistic business outlook is also reflected by a fall in foreign direct investment (FDI). During last five years India saw an average inflow of $2200 million worth of FDI every month. The corresponding figure for December 2016 was $2034 million.

For the benefit of the reader, there are five components of demand, namely, consumption expenditure, investment expenditure, government expenditure, exports, and imports. The most important component of demand is consumption expenditure, explaining 70 % of the national income in 2016. Generating and sustaining income would therefore call for strategies that would generate income.

To generate more consumer demand the FM announced person with annual income upto Rs 3 lakh will not have to pay income tax and those having income upto Rs 5 lakh will be charged income tax at 5% as oppose to the earlier 10% rate. This will give additional Rs 13000 crore income in the hand of consumers.

Acknowledging instances of tax evasion, the FM stressed the need for digital economy and big data analytics to catch the evaders. There is also massive reform in political funding, with maximum limit of anonymous cash payment now reduced to Rs 2000 from an earlier Rs 20,000.

Data suggest that there are only 24 lakh Indians who have income above 10 lakhs. Ironically, Indians bought 25 lakh cars every year since 2011. Decreasing tax rates for sure will increase tax buoyancy but its immediate impact on raising consumption demand is questionable.

Although the consumer spending data has shown a tepid increase the bug lies in agricultural income, supporting livelihood of around 60% population. Long term trend suggests, India's growth story is kept alive through higher government expenditure.

Government spending for the third-quarter of 2016 stood at Rs 3840 billion in comparison to five years average of Rs 2790 billion. Most part of government spending is because of implementation of government programmes and maintaining various government departments. Recent estimate shows GDP from public administration (Rs 3861 billion) has now surpassed the GDP from the agriculture sector (Rs 3095 billion). This increased government spending was able to keep India's growth story alive at around 7%.

However, to sustain this growth focus have to be given on agriculture sector. With an effort to revive the agriculture sector, the total allocation for rural, agricultural and allied sectors has been increased by 24% and this now stood at Rs 1872.23 billion. Likewise, farm insurance coverage under Pradhanmantri Fasal Bima Yojana has been increased to 40% from the existing 30%.

Not all aspects of government spending are bad. It makes sense to spend on infrastructure. Make in India project, that is, incentivising manufacturing in India, will not be possible without having world class roads, ports and railways. And one has to give credit for government increasing fund for building infrastructure sector.

However, money spent on maintaining too many government departments is unworthy. For instance, department of sericulture can be merged with agriculture, higher education under science and technology, etc. At the time of e-governance, better delivery of public services can happen through a leaner, thinner and stronger (read, productive and transparent) government department. Also, ornate beautification of roads and public places without providing proper infrastructure facilities is uncalled for. The FM could have done with allocating lesser fund for public administration.

Sustaining this 6.5% plus growth, and generating consumer demand will also require transferring funds to the poor and the deprived, so that distribution of income becomes more equal. Richest 1% in India own 58% of country's wealth. Around 26.1% of its 1.27 billion population lives below poverty line and 63 million people have been driven into poverty due to high cost of healthcare and education. In this age of 3D printer and data algorithm, when manufacturing process is increasingly becoming mechanized, there is a need to incentivize micro, small and medium enterprises (MSME) sector.

Problem with MSME sector is access to finance. A flourishing MSME sector is much needed for employment generation. India has a growing young population, with two-third of its population below 35 years. The FM has reduced income tax for firms (with a turnover of less than 50 crores) to 25% from the earlier 30%. To increase accessibility to finance, the FM has doubled lending target at Rs 2.44 lakh crore under PM Mudra Yojana.

There were some talks about giving unconditional cash transfers to the poor. Although at present government budget deficit and inflation are both under control however direct cash transfer is not a good idea. Cash transfer can at most help to create vote bank but not help the masses to sustain their income. The FM has desisted from this incentive and have kept the budgetary deficit under control, pegging the fiscal deficit at 3.2% of GDP for 2017-18.

In short, the outlook for this budget remains positive and much of the budgetary statements look realistic.

DISCLAIMER : Views expressed above are the author's own.

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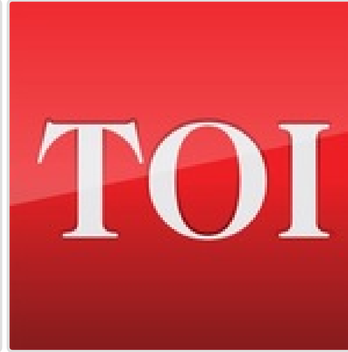

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