Nirmal Sitharaman's Challenge: Budgeting with diminished revenues*

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It is not the most conducive time for Finance Minister Nirmala Sitharaman to present her second budget. Growth is decelerating sharply, revenues are lagging behind targets, the government's off-budget transactions that make a mockery of budget estimates are being revealed, and ambitious plans to sell public sector equity are proving difficult to realise. In the event, as the Finance Minister puts together the Budget documents for financial year 2020-21, she faces two challenges. To start with, she must work to provide a credible account of what her government managed to do fiscally in the current year, 2019-20, her first as Finance Minister. That requires showing that (i) tax and non-tax revenues mobilized were not way off target; (ii) what are termed non-debt capital receipts (primarily receipts from disinvestment and privatization) were in line with budget estimates; and (iii) expenditures in different areas matched allocations promised in the budget. This is the least that is required, since most observers have argued that even budgeted total revenues and expenditures were significantly short of what were needed.

The FM's second challenge is that, building on estimates for the year gone by, she must present convincing figures of amounts she can mobilise from different sources and how much she plans to spend in different areas in 2020-21, including on special programmes and schemes (either repackaged old ones and new initiatives) which budgets tend to be filled with to lend them colour. Moreover, given the growth slowdown, the budget must contain elements that can persuade both market players, business and the man on the street, that there is a genuine effort at engineering a revival.

Meeting the first of these challenges is likely to prove difficult for the Finance Minister. The evidence suggests that in most areas revenues and receipts are likely to be far short of targets. As per the most recent figures available from the Controller General of Accounts, over the first eight months of this financial year (April-November 2019) receipts excluding borrowing by the Centre amounted to just 48.6 per cent of what had been budgeted for the whole year. Since expenditures over this eight-month period amounted to 65.3 per cent, the government could be staring at a larger fiscal deficit that envisaged, unless, receipts catch up with targets through larger increases than earlier, during the last four months of the fiscal year.

There are two areas in which is unlikely. The first is in the case of indirect taxes, especially the GST revenues that accrue to the Centre. The GST system is designed such that the revenue that accrue over the year are paid to the government across the year. Yet, Central GST collections are way short of target. The budget presented by Sitharaman had scaled down earlier estimates of GST collection and projected an average collection of central GST at Rs. 5.26 lakh crore in 2019-20, as compared with the Rs. 6.04 lakh crore budgeted for in 2018-19. This was because the actual GST collection in 2018-19 was at Rs. 4.58 lakh crore around three-fourths of what had been projected. The Rs. 5.26 lakh crore figure for 2019-20 implied average monthly collections of CGST of around Rs. 43,830 crore. As compared with that, over the 8 months April to November 2019, the average monthly CGST collection stood at

around Rs. 41,000 crore, implying that even the massively scaled down projection is unlikely to be realised.

The second area in which actual receipts are likely to be way short of targets set in the Budget for 2019-20 is receipts from disinvestment and privatisation. The Centre had set itself a target of Rs. 1,05,000 crore for receipts from disinvestment, but thus far, with just two and a half months left in the financial year, receipts under this head amount to a mere Rs.18,000 crore. There are plans afoot for rapid fire sale of public assets, but given the time constraint, receipts are unlikely to be anywhere near target. The government has got some relief from the Supreme Court which has dismissed the plea of telecom companies that are required to pay up as much Rs. 1.47 lakh crore in the form of unpaid licence fees and spectrum charges, penalties for delays in payment and interest on the unpaid sum and the penalty. But not all of this is likely to be extracted before March 31 by a government torn between its thirst for additional resources and desire to be seen as business-friendly.

It is receipts from direct taxes that tend to be bunched towards the end of the year, providing some hope of tax revenues covering some of the lost ground. However, the Finance Minister has short circuited that process. in September this year, she announced a ‘stimulus’ in the form of a huge reduction in the corporate tax rate from 30 per cent (or an effective rate of 34.61 per cent after surcharge and cess) to 22 per cent (or an effective rate of 25.17 per cent) for domestic companies that do not avail of tax incentives or exemptions. New domestic manufacturing companies incorporated on or after October 1, 2019 will pay corporation tax at the reduced rate of 15 per cent (which is an effective rate of 17.01 per cent) so long as they do not avail of incentives and exemptions. And the minimum alternative tax (MAT) applicable to companies that do avail of incentives and exemptions has been reduced from 18.5 per cent to 15 per cent. This is a huge bonanza, which is expected to result in revenue foregone of anywhere up Rs. 1.45 lakh crore in a full year or around 0.8 per cent of GDP. While the effect in 2019-20 would be smaller because of the mid-year implementation, direct tax revenues are likely to be considerably depressed.

All this does create a problem for the Finance Minister, since she would be hard pressed to meet even the slightly relaxed fiscal deficit target of 3.3 per cent of GDP she had set herself. Her problem would be that despite its ‘unorthodox’ neoliberalism, one tenet that the BJP has come to swear by is fiscal consolidation and adherence to the downward fiscal deficit ‘glide path’. There is no way the Finance Minister can ensure adherence to her own target, but she would find it difficult even to keep the deviation from the target to as low a figure as possible. Not only are tax revenues and non-debt capital receipts likely to fall far short of budget projections, but a slowing economy has meant that rate of growth of nominal GDP is now officially projected at 7.5 per cent in 2019-20 as compared with the 12 per cent assumed in the calculations made in the Budget. This would mean the not only would the numerator of the fiscal deficit to GDP ratio (which is the absolute fiscal deficit) be higher than estimated in the budget, but the denominator (nominal GDP) would be smaller than estimated. Both of these would work to push the ratio up quite significantly, unless the Finance Minister has been preparing for this by paring expenditures substantially.

If that happens it would be foolish. Because, cutting expenditure when economic growth is decelerating would only worsen the recession. And the worse the recession, the lower will be receipts from taxes and non-tax sources, and therefore, possibly,

higher the fiscal deficit. In any case, as the Comptroller and Auditor General and many others have pointed out, the fiscal deficit figure in the budget does not capture the extent of the government's borrowing, or the actual shortfall of receipts relative to expenditures. This is because there are a host of expenditures that have been kept off-budget and financed with debt such as food subsidy reimbursements due to the Food Corporation of India, sums outlaid to recapitalise banks, and expenditures on irrigation. Including these would take the deficit to 5 per cent or more of GDP. In the circumstances adding on another half to one percentage point to the figure would do little harm, while providing resources to finance crucial expenditures.

*** This article was originally published in asiavillenews on January 23, 2020.**