Budget 2017-18: The macroeconomic perspective*

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Even for those sceptical about the government's declared policy intentions—varying from cleaning the Ganga to doubling farmers' incomes by 2022—the subdued and insubstantial Budget 2017-18 was a surprise. The circumstances in which the Budget was presented were exceptional. In the midst of a slowdown in growth with signs of the onset of deflation[i], the government had chosen to withdraw and declare worthless more than 80 per cent of the value of currency in circulation by demonetising "higher value" notes. But new notes to replace the ones withdrawn were slow in coming and had to be rationed, because the indefensible measure had been poorly designed and its implementation unplanned. The consequence, as should be expected, was the expropriation of purchasing power, even if for a few months. Demand shrank, production was disrupted and well before Budget time the economy was mired in recession and deflation as the sudden shrinking of demand for lack of cash aggravated the earlier slow down and depressed prices.

If the Budget is meant to be an exercise that takes the immediate macroeconomic situation into account and lays out the government's spending decisions and their financing for the coming year, this was a perfect moment to expand spending, since growth was slow and inflation on the decline. A proactive fiscal policy was also necessary because it was a central government decision that shrank growth and inflicted much pain on the most vulnerable in the population, in pursuit of a completely misguided attempt to combat graft, black money and counterfeiting through demonetisation. These are reasons why the government **should** have opted for fiscal expansion. There was also a political reason why it was expected that the government **would** announce an expansionary budget. Elections in crucial states, the results of which would make much difference to the political standing of the central government, warranted promises of expenditure increases. In fact, sections of the opposition feared that the Budget Speech had been brought forward by a month to be able to exploit this opportunity to influence voters. Being a democracy with periodic elections at central and state levels India should be subject to its own version of the political business cycle.

What surprised many was that despite these circumstances the central theme of Budget 2017-18 was not expenditure expansion but fiscal consolidation. The budget speech made a virtue of being fiscally "prudent" irrespective of circumstances and set the fiscal deficit for 2017-18 at 3.2 per cent of GDP—just one fifth of one percentage point higher than the government's medium term target announced when the current economic situation could not have been expected. This is the same as the figure of the deficit in the revised estimates (RE) for 2016-17. The Finance Minister has not even given himself the liberty to follow the suggestion of the official committee to review the targets set by the Fiscal Responsibility and Budget Management Act. That committee had conservatively argued that, if needed, the deficit could be allowed to increase by up to 0.5 per cent of GDP relative to the recommended target of 3 per cent for the next three years.

In sum, the defining feature of the BJP government's fiscal stance is to set an upper bound to the deficit and then decide on expenditures and means of financing them.

This conservative fiscal stance of the government has had one important implication. The budget is unashamedly contractionary. Implicit in the budget's numbers and arithmetic is the projection that ratio of the centre's expenditure to GDP, which had fallen from 15.8 per cent in 2015-16, to 13.3 per cent in 2016-17, would be even lower at 12.6 per cent in 2017-18. Even this reduction may be an underestimate, since revenues and receipts in the budget have definitely been overestimated, as discussed below.

This contraction in expenditure was completely unnecessary, even if the government was unwilling to go in for a dose of additional resource mobilisation in the context of a recession, the existence of which it does not publicly recognise. Demonetisation had two consequences of relevance here. It had squeezed private consumption and investment. It had also swelled the deposit base of the banks, which were unwilling to lend to the private sector because of the uncertainties generated by demonetisation and because they were already burdened with large volumes of non-performing assets in advances made to the corporate sector and infrastructural projects. In the event, the government would do well to borrow at reasonable costs from banks with inflated deposits and restricted lending opportunities, and finance capital expenditures that would counter the recessionary consequences of depressed private investment and consumption. This would have raised output and revenues for the government, and created an environment where it could look to mobilising additional resources when the economy had overcome the consequences of demonetisation. Fiscal expansion was thus not just what was needed, but also what was feasible.

Instead of going down that route, the government has opted for a "hard version" of a neoliberal fiscal policy, which must control the deficit while meeting three other requirements. The first is that deficit control cannot be based on reliance on additional resource mobilisation from direct taxation, since the aim of fiscal policy is to incentivise and facilitate private investment. The norm is to reduce direct tax slabs and rates, on grounds of encouraging compliance, and to match corporate tax rates in the most lenient of countries abroad, so as to attract foreign investors. In Budget 2017-18, Finance Minister Arun Jaitley has refrained from additional mobilisation through direct taxation and provided minor concessions for medium and small enterprises with turnover below Rs. 50 crore and on taxes on incomes in the lower tax brackets. Direct tax revenues, therefore, are projected to register a nominal increase of just 13.4 per cent in Budget 2017-18 relative to the revised estimate (RE) for 2016-17, as compared with a 16.1 per cent increase of RE 2016-17 relative to the actual estimate (AE) for 2015-16. Even indirect taxes are expected to register a much slower growth in 2017-18 of just 8.8 per cent (BE relative to RE) as compared with 20 per cent in 2016-17 (RE relative to BE). Thus, if expenditures are to increase the government is dependent on non-tax revenues or non-debt creating miscellaneous capital receipts.

This brings us to the second requirement of a neoliberal fiscal stance that the government must contend with. The tasks of facilitating private investment and attracting foreign capital require large investments in infrastructure. Investments in private or public-private partnership projects financed by credit from the public sector banking system was an important way in which this was sought to be achieved in the recent past, which took the share of commercial bank credit to industry diverted to infrastructure from around 3 per cent in 2002-03 to more than a third by the beginning of the next decade. But this was accompanied by a large build-up of NPAs in bank advances to the infrastructural sector. Banks, therefore, are withdrawing from lending to such projects. This requires the government to step in with budgetary expenditures. Budget 2017 does claim that it is making such an effort, stating that it is making a "total allocation for infrastructure development" of Rs. 3,96,135 crore. Budget speech 2016 had stated that the "total outlay for infrastructure in BE 2016-17" was Rs. 2,21,246 crore. If these numbers refer to the same combination of expenditures that is a huge 79 per cent increase in nominal terms. This is, of course not the budgetary allocation, and it is not at all clear that this would be a comparison of like with like. If we restrict ourselves to budgetary allocations for important items of capital expenditures in the railways and roads and highways and allocations for the Pradhan Mantri Gram Sadak Yojana, the expenditure as per BE 2017-18 is Rs. 1,28.177 crore as compared with Rs. 1,01,106 crore as per BE 2016-17, which points to a much smaller nominal increase of 26.8 per cent. The increase between BE 2017-18 and RE 2016-17 is even smaller at 20.6 per cent. In sum, while the government has made a modest effort at raising budgetary allocations for capital investment in infrastructure, it expects much of the spending to come from internal or extra budgetary resources of the agencies involved. Not enough has been done here even within the requirements set by a neoliberal agenda.

The third prerequisite of a neoliberal fiscal policy is that the government needs to allocate resources for targeted welfare expenditures and schemes aimed at providing some employment, social services and social security support for the poor who are not fully included in a development strategy of this kind. It needs to give what is a regressive trajectory a "human face". It is here that Budget 2017-18 falls particularly short. The total allocations for the principal programmes for school education (the Sarva Shiksha Abhiyan, the Rashtriya Madhyamik Shiksha Abhiyan, the Teacher Training and Sakshar Bharat schemes and the Kendriya and Navodaya Vidyalayas) have fallen in real (inflation-adjusted) terms. Allocations for the Integrated Child Development Scheme (ICDS), which were reduced over the last two years, have been raised by just 13 per cent in nominal terms over the revised estimate for 2016-17, when there is a crying need to increase the "honorarium" given to anganwadi workers and helpers, which is at present much less than minimum wages. The provision for the Mid Day Meals programme in Budget 2017-18 is, at Rs 10,000 crore, only marginally higher than the revised estimate of Rs 9700 crore in 2016-17 and lower than the Rs 10,918 crore spent in 2013-14. Finally, though the allocation for the MNREGA of Rs. 48,000 crore for 2017-18 is higher than the BE for 2016-17, it is more or less equal to what was spent on this scheme in 2016-17 (RE). This freeze in allocation would in the final analysis force a delay in payments and denial of resources to the states actually implementing the programme, in what is by law a demand driven scheme.

Thus, the government's adherence to a hard neoliberal strategy has meant that even the moderate increases in budgetary allocations for infrastructure has been based on a reallocation of expenditures, given the expenditure reduction visible in the aggregate figures. In fact, the aggregate may even be worse. Even the realisation of the reduced level of expenditures projected in the budget is based on the assumption that the tax-to-GDP ratio that had fallen from 12.8 per cent in 2015-16 to 11.2 per cent in 2016-17, would remain at that level despite the adverse effects on tax collections of demonetisation and the small concessions given to personal income tax payers in the lower tax brackets and to small and medium enterprises.

One reason why the government did not rethink its fiscal strategy in the wake of demonetisation may be its erroneous belief that demonetisation in itself would deliver fiscal benefits. There was a strong opinion circulating in the immediate aftermath of demonetisation that the government would benefit fiscally, because of the existence of cash hoards linked to unreported incomes, whether legally or illegally acquired. Since those who had been holding such cash hoards were threatened with stringent action, the government expected one of two consequences. The first was that they would declare these black money hoards to avail of the Pradhan Mantri Garib Kalyan Yojana (PMGKY), under which if they paid 50 percent tax before 31 March, 2017, they were free of prosecution. In addition, 25 per cent of the declared undisclosed income had to be deposited under the PMGK Deposit Scheme 2016 for four years without interest. This partial amnesty scheme was possibly expected to bring in significant revenues to the government in fiscal 2016-17, and give it access to zero-interest credit thereafter, to help keep down the fiscal deficit while expanding expenditures. Second, those fearing to identify themselves under this scheme, were expected not to return the cash they held in the form of the demonetised notes, even if they were to lose the 50 per cent they were eligible for under the PMGKY. Since there was a deadline for exchange or deposit of the demonetised notes, they would be worthless after that date, and, it was argued, no more a liability of the Reserve Bank of India. If the latter is authorised by law to extinguish those liabilities from its balance sheets, it would have assets in excess of liabilities that, it was assumed, can be transferred as dividend to the government. This too was expected to swell the coffers of the government in 2017-18, allowing it to increase expenditures without breaching the deficit bound.

In practice these escape routes, which would have improved the government's fiscal manoeuvrability, were not available or did not open up. Neither were declarations under PMGKY large, nor was the demonetised currency that was returned to the banks and the RBI significantly short of what was expected, reducing the liabilities of the central bank (if that were possible at all). In fact, the unwillingness of the RBI to declare how much of the demonetised currency was received by it is seen as suggesting that it may even have received more than was expected because of failure to detect counterfeit currency or wrong estimation of notes in prior circulation. If despite the absence of windfall revenues from these sources the government and its Finance Minister sought to make fiscal consolidation the principal 'achievement' of the Budget, it can only be explained as being the result either of a deep ideological conviction that deficit spending must be abjured, or a belief that curtailed deficit spending allows for the strengthening of other factors that can spur growth.

The budget speech of Finance Minister Arun Jaitley does put forward a set of arguments suggesting where he expects dynamism to come from. It argued that the government's optimistic projection of a "pick up in our economy is premised upon our policy and determination to continue with economic reforms; increase in public investment in infrastructure and development projects; and export growth in the context of the expected rebound in world economy." So growth was to be delivered by an odd mix of the supply-side effects of reform and public investment in infrastructure, and the demand side effects of export recovery. As we have seen the government is hoping to ensure an infrastructural push, but the sums provided from the budget for the purpose are to register only moderate increases. The possibility of exports stimulating growth can be discounted right away since it is based on an optimistic reading of the signs of recovery in the world economy, and on an even more optimistic extrapolation of a recent mild recovery of India's exports from a decline that lasted many months and quarters.

So "reform" is the crucial stimulus for future growth in the 'macroeconomic' analysis underlying the Budget. Sprinkled across the budget speech are references to the kind of reform the Finance Minister has in mind. Of importance are the shift to the Goods and Services Tax (GST) regime, a foreign-investment friendly policy environment, accelerated privatisation, a shift from cash-based to digital transactions and above all fiscal consolidation. The last of these no doubt conflicts with the role attributed to public investment in infrastructure.

But the Finance Minister glibly assumes that the GST will help matters, even though there is a clear acceptance that the states would have to be compensated for revenue losses. The other source of optimism is receipts from privatisation. Thus, Budget 2016-17 had assumed that receipts from privatisation in different forms would yield the government Rs. 56,500 crore, up from Rs. 42,132 crore in 2015-16. The revised estimates put the amount to be actually garnered in 2016-17 at Rs. 45,500 crore (though actual receipts till end December were only Rs.23,529 crore). But, that does not hold back the Finance Minister. Receipts from privatisation are projected to be Rs. 72,500 crore. Revenues too are assumed to remain buoyant and relatively unaffected by the deceleration in growth. If these projections prove false, inflexible fiscal conservatism must involve a curtailment of expenditures.

A final source of optimism identified is surprisingly demonetisation itself. Demonetisation is seen as benefiting growth through routes other than any direct fiscal impact. According to the Finance Minister, "the surplus liquidity in the banking system, created by demonetisation, will lower borrowing costs and increase the access to credit," which "will boost economic activity, with multiplier effects." So, the expectation is that an expansion in credit induced by demonetisation would be exploited by the private sector and not the government. This discounts the effect that recession would have on investment and ignores the impact that NPAs have had on the willingness of the government to lend. Banks have indeed been pressured to offering better rates on personal loans, especially for housing. But here too credit off take is by no means booming.

Whether the unfounded belief that reform would deliver growth rather than recession is based on ignorance and bad judgment, or because the expectations of the government regarding the fiscal effects of the drive against black money and of demonetisation have been belied, is not clear. But the reliance on supply-side triggers such as reform, in a period when demand is depressed and private sector confidence low, is nothing more than wishful thinking.

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[i] The Sixth Bi-monthly Monetary Policy Statement, 2016-17 Resolution of the Monetary Policy Committee (MPC), Reserve Bank of India, released on February 8, 2017, noted: "In the fifth bi-monthly statement of December, headline inflation was projected at 5 per cent in Q4 of 2016-17 with risks lower than before but still tilted to the upside. The decline in headline CPI inflation in November and December has been larger than expected, but almost exclusively on the back of deflation in vegetables and pulses. While the seasonal ebb in the prices of vegetables that usually occurs with the onset of winter as well as some demand compression may have contributed to this outcome, anecdotal evidence points to some distress sales of perishables having accentuated the decline in vegetable prices, with spillovers into January as well." Available at

https://rbidocs.rbi.org.in/rdocs/PressRelease/PDFs/PR21164542C3DF7FC944278648E394CAF8D68E.PDF.