Distributing the rewards of reform

This article is related to General Studies-Paper II (Governance)& Paper -III (Indian Economy)

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Writer-Ashima Goyal (member of the Prime Minister's Economic Advisory Council)

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The expansive Budget reflects the fruits of fiscal consolidation, tax reform and streamlined delivery of subsidies.

Since Budget 2019 is the last before the general election this year, it was widely expected to be an assessment of the government's performance. There was a debate on whether the Budget should have announced any substantive measures since they would bind the next government, post-election.

It turns out the report card is good enough to create space for some substantial measures. Painstaking fiscal consolidation, tax reform, more efficient delivery of subsidies, and a rise in the share of capital expenditure, have created the space to reward tax-payers as well as announce a relief measure for farmers in distress without substantially compromising fiscal consolidation. It is fair that this government, which imposed the painful reforms and undertook difficult action, should also distribute some rewards of that reform.

Rewards of higher growth

It may be asked how payment of ₹20,000-₹75,000 crore can be made to farmers and the tax benefits given with only a marginal impact on the fiscal deficit. But a larger size economy can afford to spend larger absolute amounts with only a small rise in deficit ratios and borrowing requirements. The fact that India is the sixth largest and fastest growing economy in the world has some advantages as well as responsibilities to equitably share the rewards of growth.

Demonetisation, the goods and services tax (GST) and other steps towards formalisation increased the tax base, and it follows that tax rates can themselves be cut. Again it is fair that the aam aadmi, who bore some of the costs of reform, should now benefit from the success of these. It makes good economic sense to move towards a system of a wider base and lower rates. Tax receipts have grown from 10% of GDP — a level at which they had stagnated since the tax cuts after the global financial crisis — to 12%. Although the GST has not yet resulted in a rise in indirect tax ratios above 5.5%, it is likely to do so in the future as it stabilises. The transfers to farmers and tax cuts amount to only 0.4% of GDP this year and are partially funded by a 0.3% rise in tax ratios.

The JAM (or Jan Dhan-Aadhaar-Mobile) complex is the other major set of reforms that enable a smaller expenditure to have a larger impact on social welfare. Jan Dhan bank accounts opened through the country and the Aadhaar data base make a cost-effective Direct Benefit Transfer (DBT) possible for farmers.

Rewards of lower inflation

A slight rise in fiscal deficits to fund transfers to farmers does not threaten macroeconomic stability when inflation is low and food prices are crashing. In fact they are likely to help stabilise prices so that farmers do not cut production in the next crop cycle.

Moreover, this year, the revenue deficit has been maintained, the primary deficit been reduced, and expenditure on capital account been increased. Better quality of government expenditure as well as the GST tax cuts, reductions in obstacles to inter-State trade, and soft commodity prices will keep inflation low.

The Budget points out that highways are being built at the rate of 27 km per day, which makes India the fastest builder in the world. Railway safety has improved. Better implementation and reduction in waste brings down costs across the board. The shift in the Budget date to earlier in the year and the focus on spending in the first half have resulted in a better achievement of sectoral spending targets this year.

Government borrowing

The size of government borrowing is larger than what the market anticipated, and this has raised G-Sec rates. The rise in gross borrowing is because of higher redemptions but net borrowing is similar to that last year. There was a sharp rise in G-Sec yields that year. As a result, interest payments as a ratio to GDP rose to 3.2 against the budgeted 3.

But 3.4% of GDP is not a large fiscal deficit, and market conditions are likely to be more supportive of government borrowing this year. First, the international rate rise has peaked, with the U.S. Fed turning dovish and indicating that there will be no more rise; it is likely to maintain its balance sheet. Emerging market inflows are set to rise, creating demand for G-Secs up to the current cap of 6% of the domestic market. Soft oil prices will encourage foreign investors to return to Indian markets. But since global growth is slowing, inflows are unlikely to be as large as they were in 2017. Therefore, there will be more room for open market operations (OMO) from the Reserve Bank of India that support the debt market. Softening interest rates will also make banks more willing to hold G-Secs.

When international demand is slowing, it is important to maintain domestic demand. Therefore, tax cuts, more income to farmers and various schemes to improve demand for housing, which has been under stress, are all appropriate.

While the budgetary contribution to capital expenditure remains at about 1.6% of GDP there is a rise in internal and extra-budgetary resources, which are now larger than gross budgetary support. But public enterprises must be able to raise and use internal resources. This is a healthy sign of efficiency, market viability and reduced dependency on the government. Even market borrowing by such enterprises used for investment when private investment remains low, is likely to crowd in (rather than crowd out) private investment. It will raise demand which will induce more private investment. The latter remains still constrained by low demand at present, except for a few sectors where capacity constraints are appearing.

Improving efficiencies

Coming back to the issue of binding the next government, post the election, it is necessary that sharing of growth benefits is done in ways that sustain growth, reduce distortions, and improve capabilities to participate in growth.

Well-targeted transfers can be made without destroying fiscal consolidation and creating macroeconomic vulnerabilities. As competitive populism creates talk of unfunded universal income schemes, or farm loan waivers that hurt growth of farm credit, it is better to bind the next government to schemes that are less distorting.

The Budget continues the effort to reduce transaction costs and improve compliance incentives. Stamp duty amendments that seek to tax just one transaction, which will be shared across State governments, on the basis of the domicile of the buying client, will reduce a major market irritant, increase transactions and take the country further toward becoming one effective market.

As income tax returns rise, a less than 0.05% will be selected for scrutiny in non-discretionary, machine-based ways without any interface between the tax-payer and the examining officers, thus reducing potential tax-payer harassment.

India is a very difficult country to change. Problems remain, but the rewards are beginning to appear and should be greeted with cheers.

Direct tax proposals

Reference

- Exemption from income tax up to Rs 5 lakh.
- tax relief of more than Rs 23,000 crore for 3 crore middle-class taxpayers.
- Standard deduction increased from Rs 40,000 to Rs 50,000
- On the interest earned from the deposits in the bank / post offices, the limit of TDS is being raised from Rs 10,000 to Rs 40,000.
- Current rates of income tax will continue.
- Estimated rental tax rebate on the second house in your possession.
- Promote housing and real estate sector.
- Proposal to increase the limit on deduction of source tax on TDS (TDS) from Rs 1,80,000 to Rs 2,40,000.
- The scope of the rebate of capital gains will be extended to two residential houses from a residential house to taxpayers who have earned capital gains of up to Rs 2 crore.
- The tax benefit period for cheap accommodation is now being extended under section 80-IBA of the Income Tax Act by March 31, 2020.
- The income tax exemption has been preposed to increased from one year to two years for the estimated rental of un-sold property.

Fiscal program

- Fiscal Deficit of 3.4 percent of GDP in the year 2019-20
- The goal of bringing fiscal deficit to 3% will be achieved by 2020-21.
- The fiscal deficit will be reduced to 3.4 % in RE in 2018-19, which was about 6% 7 years ago.
- In the year 2019-20, the total expenditure will be increased to more than 13 percent to Rs 27,84,200 crore.
- Capital expenditure for the year 2019-20 is estimated to be Rs. 3,36,292 crores.
- Allocation for Centrally Sponsored Schemes (CSS) will increase to Rs 3,27,679 crore in 2019-20.
- Allocation for National Education Mission in the year 2019-20 has been increased by about 20 percent to Rs 38,572 crore.
- Allocation for Integrated Child Development Scheme (ICDS) was increased by more than 18 percent to Rs 27,584 crore.

Economy

During the year 2014-19

- India has made universal identity in the global economy as a strong economy during the last five years.
- Form the 11th largest economy of 2013-14, now become the world's sixth largest economy.
- Compared to any other government, average inflation has come down to 4.6 percent.
- In December 2018 inflation has reached only to 2.19 percent.
- 7 years ago, from a high rate of nearly 6 percent the fiscal deficit decreased 4.6 percent to 2018-19 at.
- CAD is likely to be only 2.5 percent of GDP this year, compared to 5.6 a higher percent 6 years ago.
- During the last 5 years, India attracted a wide foreign direct investment of $ 239 billion.

Expected Questions (Prelims Exams)

1. Consider the following statements

1. In the Budget of 2019, rebate on the estimated rental on the income tax on the unsold property has been proposed to incerase from one year to two year.
2. In the Budget 2019, in the proposal regarding the income tax, income upto Rs 5 lakh has been exempted.

Which of the above statements is/are correct?

(a) Only 1
(b) Only 2
(c) Both 1 and 2
(d) Neither 1 nor 2

Expected Questions (Mains Exams)

Q. 'Detailed Budget indicates rewards of the fiscal inclusion, tax reform and systematic distribution of subsidy. Do you agree with this statement? Discuss.

(250 Words)

Note: Answer of Prelims Expected Question given on 1 Feb. is 1(d)