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Political messaging and the Union budget

In the present situation, growth in output and employment can only come from a revival of domestic consumption and investment

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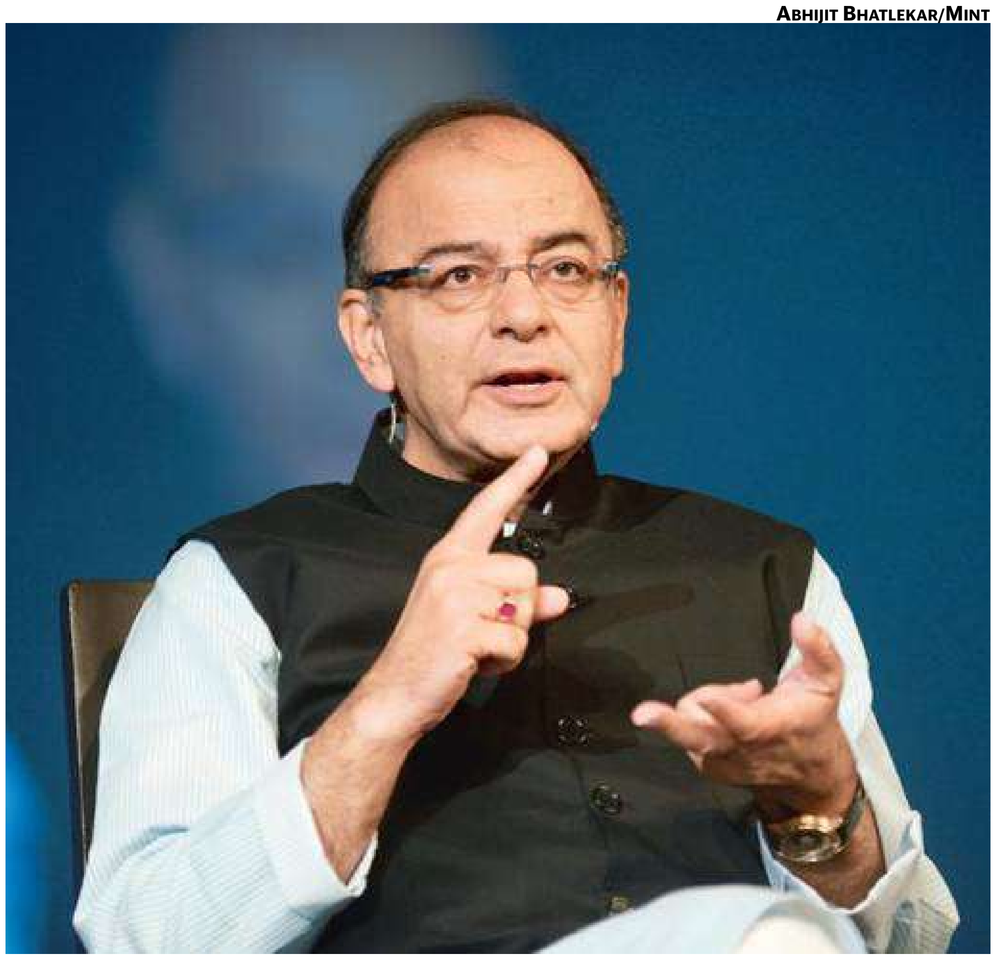

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The Union budget for 2018-19, presented in Parliament last week, was a formidable challenge for the finance minister. He had to strike a balance between the complex task of managing the economy and the political compulsions of a government in the last year of its term.

There is a slowdown in economic growth. Employment creation, already too little, has slowed down even more. Investment has slumped. Exports are stagnant. The crisis in agriculture persists. So does rural distress. The manufacturing sector shows signs of deindustrialization. The economy remains vulnerable to shocks such as a rise in oil prices or a bad monsoon. There are elections to come in eight states during 2018. And the elections for the Lok Sabha are due in April 2019.

The nature of the balancing act is obvious from three clear messages in Arun Jaitley's speech in Parliament on 1 February. First, this budget is far more about politics than about economics, not only in its symbols or signals but also in its substance. This is reflected in its explicit focus on agriculture, rural development, health, education, employment, and infrastructure, which are issues of concern for people. Second, the essential theme that runs through the speech is the concern of the government for the well being of the poor and the vulnerable. It is recognized that our market economy may work on the principle of one-rupee-one-vote but our political democracy works on the principle of one-person-one-vote. Third, the rhetoric of "ease-of-living" for people, rather different from the "ease-of-doing-business" idea, is the new mantra for a "New India". There is a populism which marks a subtle shift in emphasis from empowerment to entitlement in thinking about development.

The broad contours of the budget are worth highlighting. In the budget estimates for 2018-19, as compared with the revised estimates for 2017-18, gross domestic product (GDP) growth is projected at 11.5%. Tax revenues, in the aggregate, are projected to increase by 16.7%, while non-tax revenues are projected to increase by 3.9%. Income tax is slated to increase by 20% while corporation tax is expected to increase by 10%, which is plausible. Goods and services tax (GST) revenues are expected to jump by 67.3%, which is clearly optimistic. Total expenditure is projected to increase by 10.1%, of which revenue expenditure is slated to increase by 10.3% and capital expenditure by 9.9%, both of which will probably rise by more. But the share of capital expenditure in total expenditure is just 12%, while the share of revenue expenditure is 88%. This mix of consumption and investment expenditure is bad news, just as it would be for a firm or a household.

The fiscal deficit is projected at 3.3% of GDP. This number, in proximity to the target, might be partly attributable to the practice of overestimating revenues and underestimating expenditures. Such creative arithmetic is not new. It has characterized Union budgets for decades.

The budget speech stressed the importance of some sectors in particular: agriculture and rural development, health and education, and infrastructure, announcing a wide range of schemes and initiatives. For the agricultural sector and rural India, these include minimum support prices for crops that are 50% higher than costs, marketing facilities for small farmers, institutional credit, support for horticulture, fisheries and food processing, an "Operation Greens" for vegetables, toilets for sanitation, rural roads and so on. For education, there are several schemes aimed at improving quality and providing access. For health, two major initiatives under "Ayushman Bharat" were announced: financial support for Health and Wellness Centres (HWCs) to provide primary healthcare and a new National Health Protection Scheme (NHPS) to provide insurance to 100 million poor households for secondary and tertiary healthcare. The emphasis on infrastructure—energy, power, telecommunications, roads, railways, ports and shipping—was reinforced further through budgeted public investments.

For infrastructure, the words are indeed matched by large provisions for capital expenditure. In the budget estimates for 2018-19, as a proportion of total expenditure, capital outlays for infrastructure account for 24.4% (higher than 22.3% in the revised estimates for 2017-18). In comparison, as a proportion of total expenditure, the allocations for agriculture and allied activities at 2.6% and for rural development at 5.7% are much less but are reasonable when added up, and these proportions were about the same in the preceding year. Alas, the story of education and health is very different. In the budget estimates for 2018-19, as a proportion of total expenditure, education accounted for 3.5%, while health accounted for 2.2% (lower than 3.7% and 2.4%, respectively, in the revised estimates for 2017-18). These outlays, which are clearly not commensurate with the claims—and political messaging—in the budget speech, are simply not enough.

The initiatives on health, described as Modicare, which were the showpiece of the budget and have received much attention in the media, merit a brief digression.

The first component is a budget provision of Rs1,200 crore for 150,000 health and wellness centres that provide primary healthcare. This allocation is a mere Rs8 lakh per centre. It can achieve little. For this reason, perhaps, the finance minister hopes for contributions from corporate social responsibility funds and philanthropists.

The second component is the NHPS, which is meant to provide health insurance cover to 100 million poor families (500 million beneficiaries) up to Rs5 lakh per family per year for secondary and tertiary care hospitalization. This requires an insurance cover of Rs50 trillion. Even if the insurance risk is pooled across such a large population, the premium would be at least 0.2% (Rs10,000 crore) if not 0.4% (Rs20,000 crore), of the maximum insurance liability. The budget provision for this sum (Rs2,000 crore), to be paid entirely by the government (60:40 between Centre and states), is nowhere near enough. However, my concern runs deeper. It is not possible to achieve universal health coverage without a strong primary healthcare system which caters to outpatients. That is the reason why out-of-pocket expenses account for 70% of total expenditure under the present Rashtriya Swasthya Bima Yojana. Even for secondary-tertiary hospitalization care under the proposed NHPS, there is no system yet to regulate private health providers and health insurance firms. Of course, the government deserves credit for recognizing that the poor in India do not have any access to healthcare other than what their money can buy. Yet, it cannot abdicate its responsibility to deliver public health services to citizens.

On the revenue side, in the sphere of direct taxes, there are three changes that deserve mention.

First, long-term capital gains from transactions in equity markets held for more than one year (exempted from income tax since 2004), exceeding Rs1 lakh, will now be taxed at 10%. There will be no benefit of indexation. However, the capital gain will be calculated not from the original cost of acquisition but from the price on 31 January 2018 when stock markets were at a high (described as the grandfather clause). This has softened the blow. Yet, there is a hue and cry of protest. In my view, the finance minister should be commended for biting the bullet. It was both necessary and desirable for good reasons. Such unearned incomes went untaxed while earned incomes are taxed at 30%. It diverted investible surpluses from real economic activity, say manufacturing, to financial assets. Returns filed for Assessment Year 2017-18 show that long-term capital gains from sale of shares, reported to be Rs3.67 trillion, were exempt from income tax. The potential for tax revenues from those who are eminently taxable is enormous. And it will not dampen stock markets. Capitalism, we must remember, is made on shop floors and not in stock markets.

Second, the present cess on income tax and corporation tax, at 2% for primary education and 1% for higher education, has been abolished and replaced by a health and education cess at 4% of tax payable. This is fine in economics as equity but flawed in politics as such levies are not shared with states.

Third, the corporation tax rate for firms with an annual revenue of less than Rs250 crore has been reduced from 30% to 25%. Until now this was only for firms with an annual revenue of less than Rs50 crore. The stated object is to help micro, small and medium enterprises. Their investible surpluses will definitely increase. But it is by no means certain that this will promote employment. Job creation depends on much else.

Many have voiced a concern that a fiscal deficit at 3.3% of GDP, instead of a sacred 3%, risks macroeconomic stability. This is not just exaggeration. It is wrong. Sensible macroeconomics should focus on revenue deficits and primary deficits. The effective revenue deficit, which is the revenue deficit minus grants for the creation of capital assets, is estimated at a manageable 1.2% of GDP. The primary deficit, which is the fiscal deficit minus interest payments, is a negligible 0.3% of GDP.

For me, the most serious limitation of this budget is in its underlying macroeconomics. There is a slowdown in the economy. The world economy is also struggling along. In this situation, growth in output and employment can only come from a revival of domestic consumption and investment. That is the essential logic of counter-cyclical macroeconomic policies. The budget did not do anywhere near enough to stimulate growth.

The political messaging in the budget is clever but cannot suffice. It is not matched by commensurate outlays. Even where it is, as in infrastructure, outcomes will surface after a considerable time lag. But it is economic outcomes during the year that will shape the voting decisions of people at election time. Stimulating consumption and investment at home could have fostered growth and employment to produce such outcomes. The Union budget missed the opportunity.

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Stimulating consumption and investment at home could have fostered growth and employment. The Union budget missed the opportunity