Union Budget 2016-17: Outlook

Towards Fiscal Consolidation and a Simplified Tax Structure?

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The forthcoming union budget 2016-17 faces several fiscal challenges and it will be tough task for the government to provide positive signals to revive the private investment while pursuing the fiscal consolidation.

The government budget forms the core of the public policy and the development prospects of the country. The budgeting process involves decision-making in a complex world, which needs reconciling with different perspectives and diverse interest groups. In a conventional sense, the budget pays more attention to financial aspects in terms of control over use of public resources and is considered as an operational document that authorises revenue generation and resources allocation to various programmes.

However, in India, annual budget provides space to policy analysis and acts as an instrument to indicate reform plans. Thus, there is an expectation that the upcoming budget should address issues like adopting comprehensive policy framework to support a public investment-led growth process by easing up on the fiscal consolidation, or practice fiscal prudence as is being played out. While balancing the future policy options regarding an expansionist fiscal stance to that of the long-term fiscal credibility is not a one stop measure, the budget for 2016-17 has the unenviable task of showing the government's intent. The policy objectives will have their impact on the requirement of the financial resources and the way to raise them.

Lowering the GDP growth projection for the current year to between 7-7.5 per cent, following slow growth in the first half of the year (from April to September) to 7.2 per cent raised concerns for the growth perspectives. The ensuing budget is considered to be an important instrument to give directions on the policy choice responses of the government.

The fact that the Indian economy has remained a bright spot because of price control, modest current account deficit and a commitment to fiscal restraint, in an otherwise a gloomy international economic environment, more so in the emerging markets, does not provide hope. This has prompted the prescription of increasing government investment by slackening the fiscal consolidation requirements as determined in the last budget announcements. The idea is well intentioned and is based on the idea that public investment would complement private investment – that is, crowding in of private investment by public investment. The crowding in assumes higher fiscal multiplier for capital investment and can work in certain sectors. A careful productive investment programme in sectors based on clear evidence of higher multiplier effect can be a policy option to help improve the growth process. However, the government spending has not proved to be have higher multiplier effect in recent years. Accelerating growth to 7.8 per cent in in 2016-17 and 7.9 per cent in 2017-18 by increasing public investment needs a reality check in the prevailing fiscal situation. An expansionary stance can add to the fiscal stress.

The budget 2017-17 faces several fiscal challenges. As the fiscal corrections path under the FRBM Act has been revised and the targets have been shifted many a times, another round of target shifting should not be seen as a great aberration. However, fiscal challenges are heavily stacked against this option. The combined fiscal deficit, taking the Centre and the State together, has increased to about 7 per cent of GDP and can be higher if the States take on the accumulated debt under the 'UDAY' programme. The salary spending will grow based on the recommendations of the Seventh Pay Commission. The combined deficits and borrowing requirements are going to grow and the consequent interest payment will eat up a substantial portion of resources, which has touched about 40 per cent of total revenue at the Union level alone. The deficit induced borrowing program will shrink the productive expenditure. This will also shrink loanable funds for private investors, which will jeopardize the crowding in thesis given that the household sector financial savings has not seen significant rise. Rise in debt-to-GDP ratio will have significant implications for India's macroeconomic stability. The macroeconomic stability, considered, as strength of the Indian economy in recent years, will be weighed down and create problem for flow of foreign direct investments. Despite a supportive attitude towards higher public investment to facilitate higher growth, it will be difficult to stray from the fiscal consolidation process in this budget.

Indeed, it will be tough task for the government to provide signals to revive the private investment while pursuing the fiscal consolidation. The need for focusing on infrastructure, rural sector, particularly agriculture and irrigation, and restoring the health of the banking system is undeniable. Stalled infrastructure projects in the past have cost the economy dearly. The absence of private investment in highways and roads makes it imperative to think about innovative financing schemes and revival of PPPs. The relatively poor monsoon has adversely affected the rural economy and reduced the demand for commodities, thus affecting the growth of the economy. The health of banking sector is a matter of concern due to increasing non-performing assets and there is need to look at this crucial sector. The budget also has to provide for the ongoing schemes, MGNAREGA, social sector schemes, and ambitious programmes to make the 'Make in India' campaign a success.

The budget decisions will revolve round taking tough choices of controlling spending and making additional efforts to raise revenues to boost the capital expenditure. The decline in oil prices from $100 per barrel to less than $40 in 2015-16 helped the government to reduce the subsidy outgo and generating additional revenue by increasing excise duties. As the benefits from this oil price reduction flats out, the government has to find additional resources to increase the capital expenditure. Divesting the government's stakes in in public sector entities and taking recourse to PPP are two important measures that may get emphasis in this budget. The divestment has remained tepid and there have been some disappointments with the PPP mode of financing the infra-projects. The recommendations of the Kelkar Committee on PPP will be useful while taking a relook at the PPP mode of financing the projects. Although the growth seen in indirect taxes due to oil price advantage will taper off, it has reached a high level, which needs to be maintained. It is in the direct taxes, where the government needs to focus more to improve the performance. Efforts to reduce subsidies through DBT schemes, controlling unproductive expenditures, and restructuring expenditure by prioritising should continue to get emphasis in the ensuing budget to free resources.

Tax regime reform

This fiscal, the government is likely to face a shortfall in direct tax collection, about Rs.40,000 crore as per the estimates given by the government agencies, due to economic slowdown and indifferent corporate earnings. The challenging financial scenario in 2016-17 will not make it easy for the government to provide any tax benefits, like tweaking the slabs, to individual taxpayers. The focus should be to simplify the tax regime and expand the tax base. The Tax Administration Reform Commission (TARC) has pointed out that only 3.3 per cent of the population pays tax in India, which is way below that in many other countries. The TARC has suggested several measures to bring the high value evaders who deal in cash into the tax net. The government's proposal in 2015-16 budget to reduce the corporate tax rate to 25 per cent from the current 30 per cent over the next four years and remove the tax exemptions contributing to a substantial part of the government's tax expenditure looked very promising in simplifying the tax structure. The ensuing budget should continue with the commitments to simplify the tax regime, broaden the tax net, and reduce distortions in the system.

The simplification of the tax system assumes significance in the ensuing budget as two committees, TARC headed by Parthasarathi Shome and R V Easwar Committee have recommended a friendlier and accountable tax administration. The TARC proposals include widening the use of the permanent account number; abolition of the post of revenue secretary; a complete revamp of the dispute resolution mechanism, and spending a tenth of the tax department's budget to improve taxpayer service. While not all the proposals may see the light of the day, the government needs to consider the ones that can be implemented easily. The Easwar committee also suggested a friendlier tax regime and measures to ease litigation. The report has proposed amendments to the tax laws and proposed changes through administrative instructions to remove many irritants in the tax system.

The high indirect tax collection in this fiscal was due to a hike in excise duty on diesel and petrol, withdrawal of tax exemptions for motor vehicles, increase in clean energy cess and hike in the service tax rate. What is important in the context of budget for the year 2016-17, is to keep up the buoyancy to meet any eventuality of shortfall in the direct taxes. Based on the changes in the indirect tax in 2015-16, there are expectations that the ensuing budget will take up for further initiatives to simplify the tax system. The simplification and rationalisation of indirect taxes should be carried out keeping the eventual introduction GST in consideration. Changes in the Cenvat rules are also needed for easier transition to the GST regime.

The most important indirect tax reform, the introduction of GST, aimed at unifying the myriad taxes at both Central and State levels and reducing the cascading effect has been delayed mostly due to lack of political consensus on this. The passage of the Constitutional Amendment Bill is still stalled; it is not clear whether the budget session will see unanimity. After the Constitution Amendment Bill is passed in Parliament, there are three more legislations - Central GST (CGST), State GST (SGST) and Integrated GST (IGST) that need to be passed before the GST is implemented. However, it is expected that the

Government will take initiatives in the 2016-17 budget to make the indirect tax structure less complex so that its integration with the GST becomes smooth.