BUSINESS

From growth trend to black money menace: 10 parameters to assess Arun Jaitley's 2017 budget

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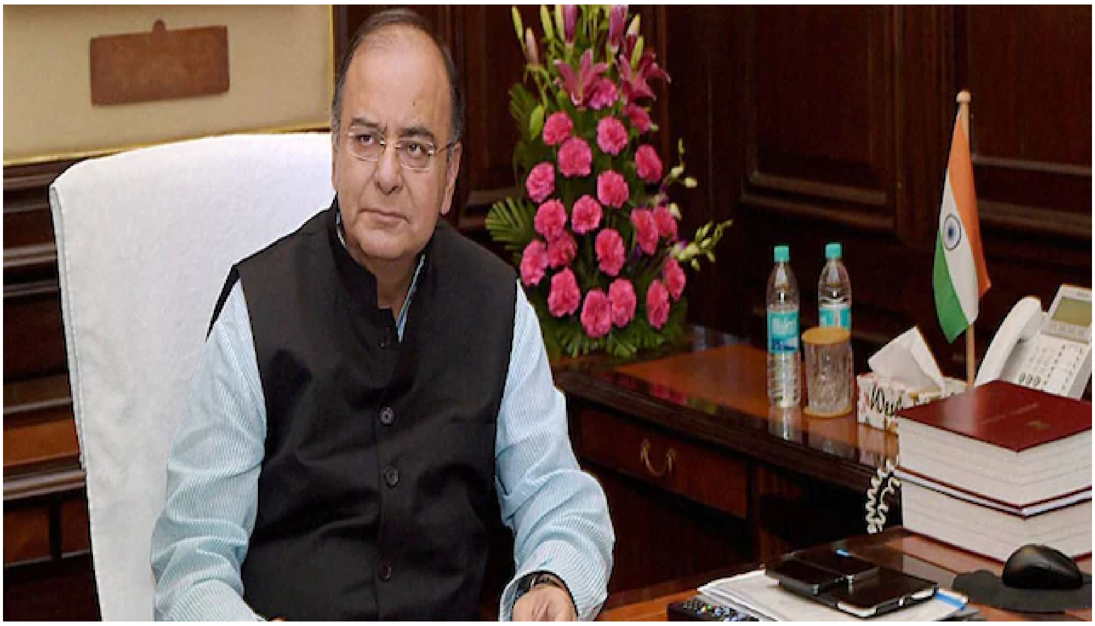

The central budget for 2017-18 is going to be presented under certain challenges confronting the government. A few challenges are purely external while some of them are internal. Credibility of the government will be in for public scrutiny, especially among the economic experts. Unfortunately, the government no more enjoys the luxury of being able to initiate harsh reform measures as it is hardly a couple of years away from the 2019 polls. Besides, winning at least three states including Uttar Pradesh is crucial not only to set the trend for the final round in 2019 but also in order to prevent any possibility of a coup within. Being a shrewd political strategist, Prime Minister Narendra Modi must have worked out his government's fourth budget. Among many expectations from different sections, the budget for 2017-18 is likely to be assessed on the basis of quality response to the following issues:

Clarity about economic growth trend: Finance Minister Arun Jaitley is expected to spell out in clear-cut terms the exact state of the economy, especially growth trend and prospects as well as its implications in terms of employment opportunities. There are conflicting signals about growth prospects. While there is unanimity about the likely deceleration in growth rate ranging from 6.6 percent to 7.1 percent - dismissing politically-biased estimate of 5.6 percent growth rate by the former PM, the available supporting data indicate an opposite signal. It is elementary economics that fall in consumption should lead to deceleration in growth. That is what I also expected while listening to the Prime Minister's broadcast on 8 November, 2016. Ironically, all experts including the Chief Statistician of the government have estimated decelerated growth rate either on the basis of data up to October, that is pre-demonetisation or have gone by emotions which in many cases are outbursts of anger.

Finance Minister Arun Jaitley

However, indicators since the last couple of weeks indicate a different trend. The latest available data on industrial production, that is for November, indicates growth by 5.7 percent which is a substantial improvement over the marginal growth rate witnessed in the previous month. The trend is further supported by 31.6 percent rise in excise duty collections as there is direct correlation between the two. Moreover, a 4.4 percent rise in non-oil and non-gold imports during the third quarter of the current fiscal year cannot be only for consumption. On the other, substantial portion of import requirements are for oiling manufacturing process. Not just that, exports during the period went up by 5.7 percent, which means, though domestic market got weakened due to cash crunch, the international market came to the rescue of the manufacturing sector. However, one has to wait and watch for a couple of more months. That is why the Finance Minister and the preceding Economic Survey are expected to clarify the exact state of the economy so that the country would gear up to face the impending situation.

Declining investment trend: It is expected that the government is aware of the fall in investment trend which cannot be ignored at any cost, especially by the visionary PM who came to power on a development flank and started with ambitious schemes like Make in India. Investors have been pinning hopes on Modi for facilitating an investment-friendly environment. Despite all talks of business-friendly schemes, the ground reality is a fall in investment as percent of GDP to 31.85 percent in 2016 as against investment/GDP ratio of 40 percent in 2012, that is the year when investors were thinking in terms of looking for business opportunities outside the country. New investment proposals fell to Rs. 2 lakh crores during the third quarter of this fiscal as compared Rs. 2.4 lakh crores worth of investment. Fall in new projects in real estate sector may be blamed on demonetisation and it is a separate developmental model requiring debate. However, overall fall in investment trend is certainly something to do with the gap between the Prime Minister's vision and his trend is certainly something to do with the gap between the Prime Minister's vision and his team's mission to translate the former. It is to be seen how Budget for 2017-18 would respond to the situation that is likely to be presented in a right perspective by the Economic Survey on 31 January.

Preventing outflow of foreign investment: In the background of recent developments, especially hike in Federal rate and an expected further hike as well other major global developments such as transfer of power to *Swadeshi* president in the US, the government's challenge today is how to prevent outward movement foreign investment rather than attempt to attract. Already, US $7.3 billion of foreign portfolio investment (FPI) has been withdrawn during the third quarter of the current fiscal year. Outflow of private equity was a record US $16.4 billion during the period. No wonder the rupee has depreciated. Besides instability in the market and weakening of investor confidence, this trend is bound to put pressure on import requirement of crucial inputs such as crude oil along with rising price of crude. Are we in for imported inflation? How does the FM intend to respond to global developments from which we cannot get insulated?

Strategy to boost consumption: Consequent upon demonetisation, overall consumption has fallen by 30 percent in the very first month. Consumer durable goods experienced demand fall by 54 percent while fast moving consumer goods (FMCG) faced demand shortfall by around 22 percent, though of late industry sources indicate a positive turnaround in the situation. However, the government should not ignore the importance of strengthening a domestic demand base which is more reliable rather than depending on international market -- that too under unpredictable conditions due to various factors including a possible move towards a protective market. However, the FM's options are limited. With a decision to switch over to a Goods and Service Tax (GST) regime from 1 July, the option of cutting down excise duty to boost consumer sentiment is closed. It is to be seen whether the FM proposes to put more money in the hands of people through tax relief in income tax.

Another option which the government can weigh is strengthening the time-tested rural market. If the government goes for Universal Basic Income scheme under which every one below the poverty line is expected to get cash transfer of Rs. 1000 per month, it may act as a real catalyst as it aims to strengthen purchasing power of 270 million persons below the poverty line. We have to wait and see whether the FM gets guided by the PM's political acumen or Niti Aayog's off-the ground thinking bereft of any economic logic.

Fiscal consolidation: The FM has been claiming that revenue collections have gone up substantially due to improvement in tax compliance – both on account of direct taxes and indirect taxes. Ironically, a debate has started about introducing flexible leverage in terms adhering to fiscal norms as per the Fiscal Responsibility and Budget Management Act (FRBM) under which fiscal deficit is supposed to be brought down to 3.0 percent of GDP in 2017-18 from 3.5 percent of GDP during the current year. There is a rumor of going for a band fiscal deficit target of 3 percent-3.5 percent. Apart from defeating the very purpose of the FRBM Act binding successive governments within fiscal norms, any attempt to get out of the FRBM discipline also raises certain fundamental questions. How would the government claim that revenue collections have improved because of demonetisation and at the same time be looking for flexible space in terms of fiscal deficit target -that too when GDP is expected to get decelerated? A rethink on fiscal discipline introduced by the Atal Behari Vajpayee government may not be taken lightly by many experts.

Income tax relief: India compares well in terms of income tax rates with highest rate being 30 percent over and above Rs. 10 lakh income. Including surcharge, it works out to 34.6 percent which is lower than the maximum rate at 39 percent in China and 45 percent in US. In India, income up to Rs. 2,50,000 is completely exempted from income tax unlike a minimum contribution to exchequer in terms of income tax as prevailing in China and US. We have come a long way from the maximum marginal rate at 97.25 percent in 1973-74. Still, the fact is that hardly three percent of the population are within the income tax net that has resulted in a parallel economy running on account of black money. Through demonetisation, the government has succeeded in getting more than 90 percent of the unaccounted money into the banking system. In the process of unearthing black money, honest citizens played a major role by giving wholehearted support despite tremendous hardships due to cash crunch as well standing in queue for hours. In any inconvenience of this nature and volume, it would have resulted in a public revolt. Now is the time to acknowledge the cooperation extended by honest citizens through suitable rewards in terms an income tax relief. Revenue collections are bound to increase due to improved tax compliance. Is it not time to share fruits of better tax collections with the general public which in turn would help in reversing a falling trend in consumption.

Fight against black money: Demonetisation is certainly an indicator of the PM's determination to fight black money menace. At the most, this can be the beginning of a fight against black money and this step is only curative in nature. Certainly, it cannot be a preventive measure. Moreover, a large part of black money has already got converted into real estate, gold and other investment channels like penny shares. People have been eagerly waiting for measures to tackle black money hidden in different forms of investment. More importantly, effective measures are needed to breakdown the channels facilitating money laundering – be it the trading route or bank channels or foreign portfolio investment route.

Electoral funding: Political donation including electoral funding is the major cause of black money generation. Non-transparent contribution to political parties and candidates in cash is compulsion of our immature democracy unlike countries like the US. A transparent contribution is not a practical proposition in India though there is the odd exception like the Tata electoral fund. The PM has already started a debate on state funding. It is high time the FM initiates a forward step in this direction through the current year's budget – either through budget allocation or through tax incentives for contribution to the fund or may be through a specific surcharge.

Banking reforms: It is easy to blame commercial banks for bulging non performing assets (NPAs). Unless one goes into the route cause, the stressed assets problem cannot be resolved. Whether bad debts are due to inability of the borrowing corporate units to service which has a direct link with certain outdated economic laws or willful default as in cases like Vijay Mallya, the fundamental issue is whether commercial banks are allowed to function within banking norms. Unless steps are not taken to provide functional autonomy to banks, one cannot expect them to function with accountability which prerequisites functional autonomy. This is possible only when the government reduces its equity holding below 50 percent. Otherwise, cases like Kingfisher are bound to get repeated with political patronage and not allowing banks to apply Know Your Customer (KYC) principle in such special cases. Does the government have any concrete thinking in this respect? Infusion of funds may take care of immediate capital requirement. But this doesn't help in resolving the burning problem. People would also like to know when the commercial banks would get empowered with the Bankruptcy Law already passed by Parliament?

Empowering weak: The FM has been claiming substantial improvement in revenue collections through both direct and indirect taxes. There is every reason to believe him. With tough measures such as demonetisation to be followed by other expected harsh measures, a strong signal has been sent that the Modi government means business. Tackling of black money is no more just an election campaign issue; it has become the mission of the government. Whatever the improvements seen in revenue collections so far, it is bound to accelerate. Naturally, the time has come to share the fruits with economically weaker sections – may be in the form of increased expenditure on social welfare programs. Is it too much and too early to expect such a gesture from the government?

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