Logo

Subir Gokarn: A big leap forward

We now see an emerging link between objectives and financial commitments

Subir Gokarn February 28, 2015 Last Updated at 22:50 IST

At a big picture level, I would assess the Budget on four criteria. First, did it take advantage of the full-term horizon that the government has and chart out an economic and fiscal road map for the rest of its term? Second, did it address significant tax challenges, in terms of broadening the base and simplifying the overall framework? Third, did it address critical expenditure issues – reducing subsidies – meaningfully? Fourth, did it adequately accommodate the rather far-reaching recommendations of the 14th Finance Commission, which has proposed a significant increase in unconditional transfers?

On the first criterion, I think the broader vision, which linked up the several initiatives that the government has launched during its first nine months, could have been more explicit. But, it was there alright, with the speech alluding to several of them and explicit budgetary provisions being made. One great value to such an approach is that people can now take as given persistent government commitments to these initiatives of missions and plan their responses accordingly. That the government is going to stay the course with these was made quite clear in the speech and this is a good sign. There were, of course, some explicit road maps laid out, for instance, in the reform of the direct tax system. But, at a broader level, we now see an emerging link between objectives and financial commitments, which is what the core purpose of a budget is.

Read our full coverage on Union Budget

On the second benchmark, there were both positives and negatives. The finance minister strongly reinforced his commitment to implementing the goods and services tax (GST) by next year. The legislative hurdles are daunting and it will require very deft management. So the articulation of priority was reassuring. However, the actions on specific indirect tax rates appeared to contradict this position. In moving towards a GST, rates across different goods and services should converge to what is likely to be the single rate. More dispersion, such as was reflected in some of the changes in the Budget, will make the process of harmonisation that much more difficult.

On the direct tax front, however, the commitment to phasing out exemptions in the movement to a lower rate is very welcome. Complexity, opacity and the consequent discretionary power of the tax administration imposes an extremely high cost on the system. I think this process could have been accelerated, perhaps by giving taxpayers an immediate choice of a no exemptions-lower rate combination and imposing a four-year sunset clause on exemptions. Nevertheless, this is a positive step; it will, of course, have to be accompanied by organisational reforms in tax administration.

On the expenditure criterion, the announcements are very positive. The commitment to shifting the delivery of subsidies and benefits to direct transfers now has high credibility on the basis of the penetration of the Aadhaar number and bank accounts. The Economic Survey for 2014-15 referred to it as the "JAM" — Jan Dhan-Aadhaar-Mobile framework, a reference echoed in the Budget speech. While not necessarily yielding very significant savings immediately – not much credit has been taken in the Budget estimates – this lays the foundation for some dramatic changes in the effectiveness of targeting and the cost of delivery. Both will yield substantial fiscal dividends over the years. What is needed to back these capabilities up is a higher level of coordination between ministries, so that the delivery of several benefits to individual households can be done at the least possible cost. There are some implications for state governments as well, which I will come to later.

To me, the most significant development on the expenditure front, which I have been a persistent advocate for, is the setting up of the National Infrastructure and Investment Fund (NIIF), with an initial contribution of Rs 20,000 crore. The finance minister referred to the intention to leverage this amount, either through direct borrowing or through investments in infrastructure companies that could then borrow more. I see this as the best way to reconcile the inescapable need for public investment in infrastructure and the need to maintain fiscal discipline. This was, of course, compromised on a bit, by budgeting the fiscal deficit at 3.9 per cent instead of the earlier commitment of 3.6 per cent. But, an assurance was given that the entire slippage would be used to finance investment. I think this could have been avoided, particularly when the revenue deficit is a relatively high 2.8 per cent. Be that as it may, the key to dealing with the infrastructure crisis – it is indeed that – is to quickly operationalise the NIIF and use its resources, in the first instance, to rescue some critical projects that are now languishing on the books of banks as non-performing assets.

On the fourth indicator, transfers to states, the Finance Commission has shifted the federal framework strategically towards greater autonomy and flexibility in expenditure. In fact, with the GST coming in, we are moving towards a virtuous combination of centralisation of the revenue mechanism and decentralisation of the expenditure mechanism. The merits of centralisation of tax collections are well understood in terms of their allocative and operational efficiency gains. However, the merits of decentralised powers to spend depend critically on the institutional and knowledge capacities that states have to execute and monitor their expenditure plans. These, of course, vary widely across states. In the absence of efforts to enhance these capacities, decentralisation could significantly exacerbate inequalities across and within states.

The Budget has accommodated the higher devolution by reducing the Centre's commitments to many sectors in which states have responsibilities. This is logical. But, this needs to be accompanied by a strategy to ensure that states spend their newly enhanced resources well. This was not laid out in the Budget, of course, but should be a high priority for the government.

Overall, I think the Budget delivered well on the first three criteria; the fourth will be a work in progress for some time and the process needs to be nurtured. Of course, the devil is always in the implementation!

The writer is director of research, Brookings India, and former deputy governor, RBI