Budget 2023 Is Optimistic But Indifferent to Past Failures

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Rising unemployment poses a serious challenge. Credit: Fett/Flickr (CC BY 2.0)

analysis

Economy

Once again, the finance minister has failed to directly address the job creation crisis.

Deepanshu Mohan

Economy

Government

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The Union budget speech by finance minister Nirmala Sitharaman – in her last full budget before the 2024 polls – highlighted seven key priority goalsfor this year's fiscal outlay map: inclusive development; last mile development; infrastructure and investment; green growth; youth; and financial sector. Most of the key announcements made were in the third and last of these areas. Other goals, despite their noted mention, seemed less important from a fiscal mapping exercise of allocations done.

Key fiscal numbers were kept in line with the broader market expectations, with the fiscal deficit revised to 5.9% of GDP (the finance minister added that the Union government remains committed to bringing the fiscal deficit down to 4.5% of the GDP by 2025-26); gross borrowing levels kept at Rs 15.43 trillion (which is still very high); a net tax revenue rise seen at around 11% (though the source for a difference of Rs four lakh crore in the presented tax and non-tax revenue collection outlay will need to be accessed, given how badly the government has done on its disinvestment targets so far); and the overall government expenditure – driven by a higher outlay for government capex and railways – is up about 7% of GDP.

On personal income tax, incentives assigned in terms of tax rate deductions and rebate announcements are broadly to encourage average middle class taxpayers (who actually pay more tax annually than the corporate class in India) to subsequently move towards adopting the 'new tax regime'. Additionally, a lowering of the surcharge on the super-rich (those earning Rs 5 crore or more a year) was announced, which means the effective tax rate is lowered from 42.7% to 39% with the hope to immediately incentivise the 'super-rich' to shift to the new tax regime.

A longer section-wise analysis on the social sector allocations and other finer details will be put across by our InfoSphere team in the days to come. But overall, in terms of a macro-review of key announcements made, this appears to be a 'no-gain-no-pain' budget, which indifferently ignores its own previous failings to create jobs. Nor does it address the concerns of India's poor social spending landscape, along with the developmental priorities of the 'young'.

I will particularly analyse three announcements: the likely (no) effect of the 3.3% capex-GDP announced hike; the personal income tax rate revisions announced (as per the new tax regime) for this fiscal year; and the indifferent-callous attitude meted towards the existing job creation crisis, which the finance minister has failed to directly address.

Yes, a big jump in year-on-year increase in capex outlay and no change made in the long term capital gains tax on equity will be welcomed by the stock market in the short term (we already see the Sensex responding positively to this). My broader concern here, though, is more of what's likely to happen on the poor-private investment status quo in the medium to long term scenario.

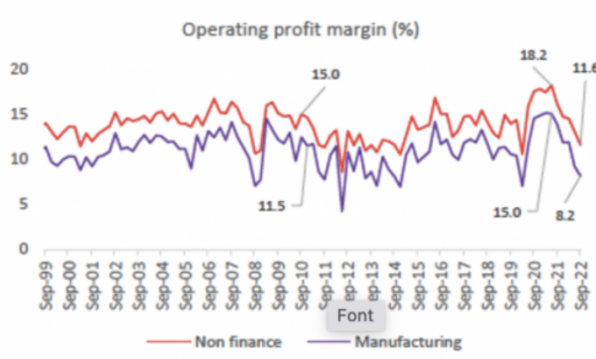
An increase in government capex has done/may do little to increase private investment

On government capex, the government will now spend roughly Rs 10 trillion on longer term capital expenditure in 2023-24, for a growth-push objective (highlighted in the aftermath of the COVID-19 crisis). The current allocation, announced for this budget, is higher than the Rs 7.5 trillion budgeted for in the previous year and the highest on record. The year-on-year increase of 33% is only marginally lower than last year's 35% jump. The ratio of capex-to-GDP, which rose to 2.7% in 2022-23, is estimated at 3.3% in the new financial year, Sitharaman said.

It is timely to mention, as argued earlier, the government capex drive has so far yielded less positive dividends on both, driving macro-growth overall, or in terms of crowding-in private investment opportunities. The robust 10.4% second quarter FY23 growth in real Gross Fixed Capital Formation (GFCF) reflection past government projects, camouflages the fact that real fixed assets of non-finance and manufacturing companies have actually contracted in real terms (-4.9%/-6.3% YoY), according to a recent policy brief. The share of private capital formation has also declined to roughly 7.8% of GDP (FY23E), while that of the public sector has risen to 10% or so.

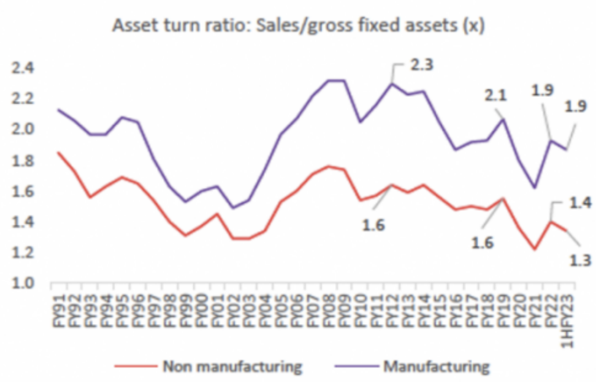
My sense is that an increased government capex outlay, as welcomed it will be in the short term, may actually do very little to change the underlying circumstances for the overall investment situation, where at 75% private sector capacity utilisation, most of the private firms remain reluctant to invest more or in new capacity. The charts below reflect the full story in data. Margins for companies have plummeted despite high sales growth, and may remain low due to further deceleration in sales. Asset utilisation rations have remained below pre-covid levels and significantly lower than in FY12.

Exhibit 29: Margins for companies have plummeted despite high sales growth, and may remain low due to further deceleration in sales



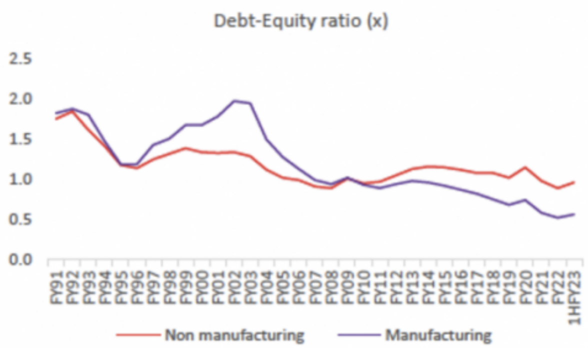
Source: CMIE, Systematix Research

Exhibit 30: Asset utilization ratios have remained below pre-covid levels and significantly lower than in FY12



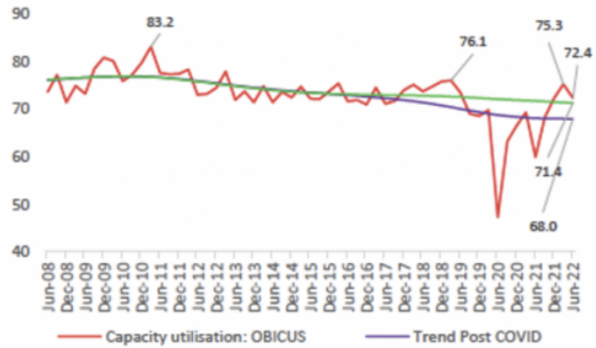
Source: CMIE, Systematix Research

Exhibit 31: Declining trends in the gearing ratio



Source: CMIE, Systematix Research

Exhibit 32: Capacity utilization of the manufacturing sector (%)



Source: RBI, Systematix Research

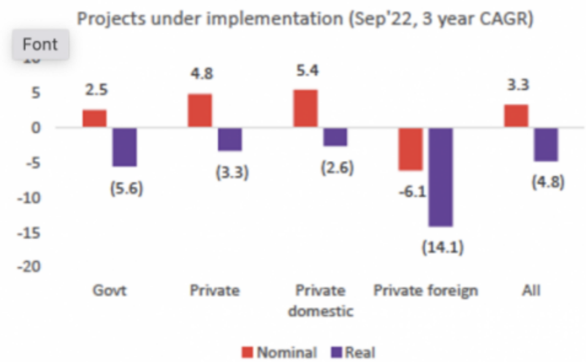
One must then ask the larger (unasked) question here to the finance minister. It's been nine years of the Modi government in power. As Modi was seen as a pro-investment, pro-corporate prime minister coming to power with one of strongest political mandates since the mid-1980s, how has private investment growth in India failed to pick up in a

sustainable manner? If the shock-punctures of demonetisation and a hurried GST-implementation cycle temporarily disrupted the private investment cycle post 2016, the actual investment growth didn't pick up for much of the period later too.

Despite all the fiscal incentives – from corporate tax cuts to schemes like PLI, Make in India to successive hikes in increased government capex for encouraging a private crowding – in effect almost none have consequentially changed the status-quo in terms of enhancing private investment across sectors (leaving the Adani Group aside of course).

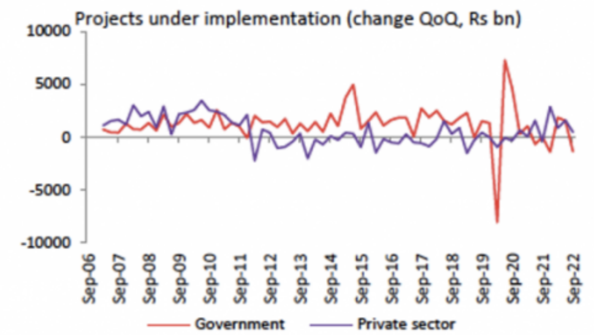
The futility of a failed private investment crowding-in strategy may, in the near future, give way to crowding-out effects, which will be subsequently worse for growth prospects in a climate of global investment uncertainty. Moreover, as the charts below show, many public and private projects under implementation have contracted over time due to a number of factors. Pace of projects (public and private) under implementation has been much flatter than, as seen in the 2006-2011 period.

Exhibit 35: Projects have grown by 3.3% since mid-FY20, lesser than WPI inflation of 8%, resulting in contraction in real terms



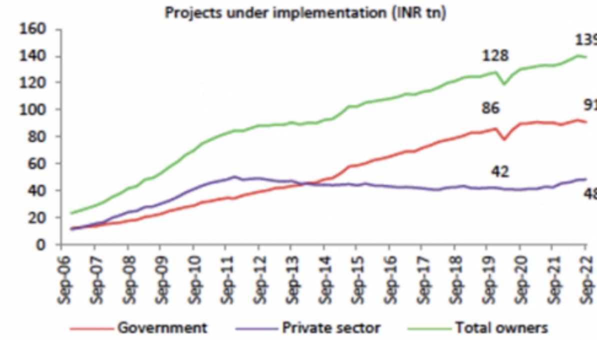
Source: CMIE, Systematix Research

Exhibit 36: Slower announcements, & higher completion led to a decline in govt projects, higher announcements & slower completion led to higher private projects



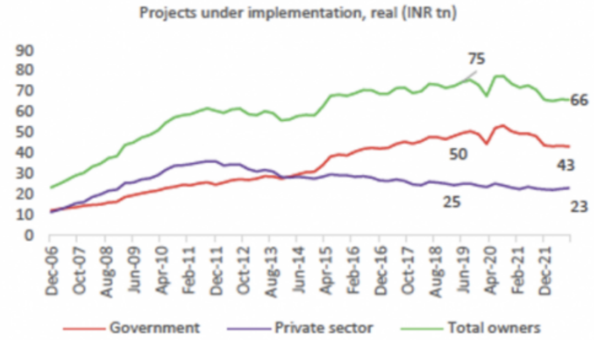
Source: CMIE, Systematix Research

Exhibit 37: Projects under implementation, govt projects stopped growing, private rising due to high inflation



Source: CMIE, Systematix Research

Exhibit 38: Pace of projects under implementation much flatter than in 2006-2011



Source: CMIE, Systematix Research

Furthermore, as argued before, there is also an increased discrepancy in the overall planned expenditure and the unplanned expenditure ratios when one reviews the revenue vs. capital expenditure account side. Capital expenditure (plan vs. non plan) also follows a different pattern with actual and budgeted expenditure mapping throughout

the years, but, for revenue accounts, when we look at which of it was planned and unplanned, there is still a wide divergence in trend across the years-indicating a large increase in non-plan expenditure overheads (especially prior to 2015).

On personal income tax revisions

Based on the revisions done in the new tax regime, the middle class, which in the Indian scenario can be sub-categorised into low-income middle class, middle class, and upper-middle class, may particularly be benefited, especially the lower income and middle income (middle) classes.

For someone earning Rs 9,00,000 per year, (s)he will now need to pay Rs 45,000 as tax instead of Rs 60,000 from the previous tax slab rates. The overall no-tax rebate has also been increased from Rs 5 lakh to Rs 7 lakh, which will enable more low-income earners to not pay tax.

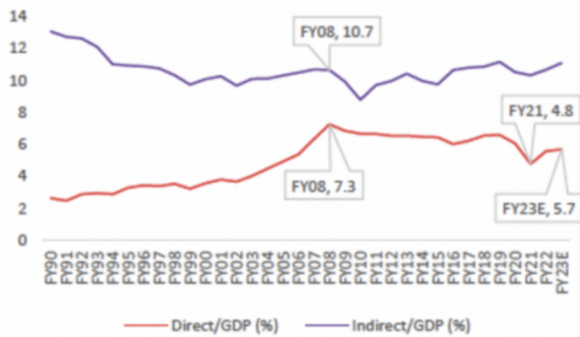
On the direct tax end, this measure was desperately needed for two reasons. One, given high inflation (food prices and fuel costs) and a sustained low income/wage growth level seen across middle class (plus low income) sections, the overall 'middle class' in India, over the last few years, was being squeezed into spending more-while also paying a higher tax rate on increased earnings.

A marginal tax rate deduction will help in increasing their disposable income, which is vital for both purposes: either increase household savings (which has been declining over the last decade) or in increasing aggregate low-income consumption demand (which has been a concern since 2016 at least).

Secondly, the skewed nature of indirect-direct tax regime in India, regressively impacts the average consumer in India, particularly the low-income (and middle-income class).

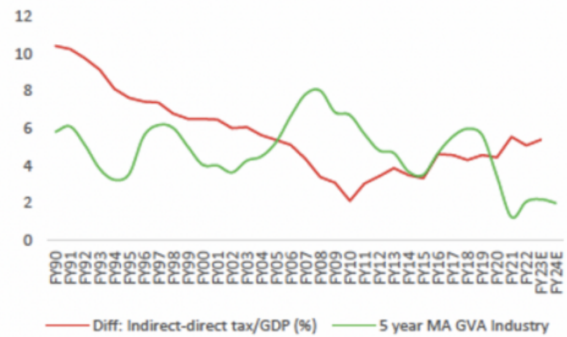
The indirect taxes/GDP ratio increased to 11% from lows of 8.8% in FY10, more recently through the increase in taxes on fuel and broad basing GST to even basic consumption items. This significantly reversed the convergence between indirect and direct tax incidence during the period of FY90-FY10, which saw a sharp decline in indirect tax rates and a spectacular gain in tax buoyancy led by higher direct tax incidence (See Exhibit 43-45 below sourced from here).

Exhibit 43: India has increasingly relied on indirect than direct taxes since the post GFC recovery, indicate reduced tax buoyancy



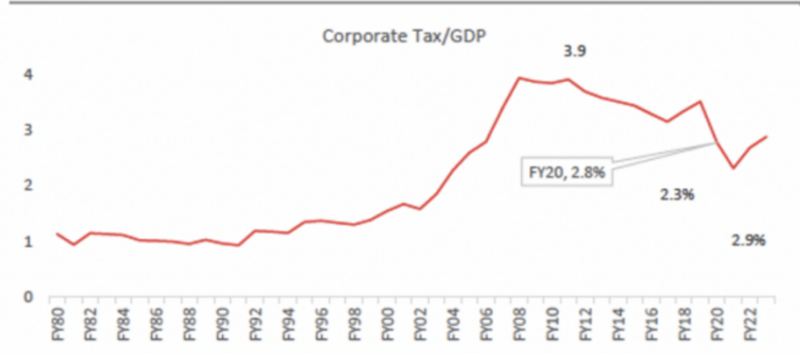
Source: CMIE, Systematix Research

Exhibit 44: Convergence of indirect-direct tax incidence prior to GFC 2008 saw a structural uptrend in growth despite the cycles



Source: CMIE, Systematix Research

Exhibit 45: Incidence of corporate tax at 2.9% of GDP equals pre-covid, the declining trend since FY10



Source: CMIE, Systematix Research

Also, the private income tax rate for the salaried class (despite the revisions announced today) are still likely to be on average much higher than what the corporate class pays in aggregate. The new private income tax regime will see more registrants now – given the benefits announced but that may do little to radically transform the indirect tax reliant (pro-corporate) tax regime in India. Figure below highlights the massive gap in the overall rates of taxation on 'personal incomes' vs. 'corporate income'.

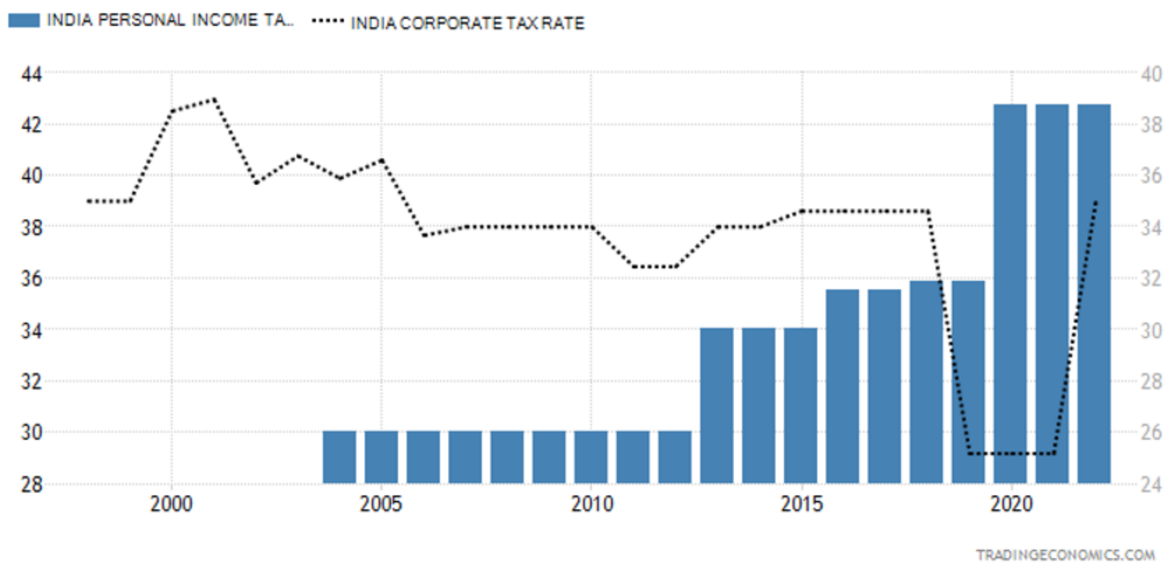


Figure: Personal Income Tax Rate vs. Corporate Income Tax Rate (%)

The finance minister announced a lowering of the surcharge on the super-rich (those earning Rs 5 crore or more a year) such that the effective tax rate is lowered from 42.7% to 39%. This might have been done with the hope to immediately incentivise the super-rich to shift to the new tax regime but it begs one to ask the question: Why has the Modi government continued to favour its tax policy towards the 'pro-corporate super-rich'? I had argued earlier for the case to levy a 'consumption tax' on the top 1% for fiscal reasons.

For those wondering whether being 'pro-corporate' in tax policy works to a government's advantage, some context here might help. Corporate tax cuts, in a broader sense, provide a sugar-rush to an economy. Investors feel happy, albeit more temporally in the short term, buying more stocks, which puts a smile on the faces of stock traders and India's financial markets. Others will invest majorly in greater capital-intensive modes of production, which may drive nominal growth rates for a period, but hardly do much to boost employment or create higher wage-paying opportunities.

What more could have been done on tax reform?

As argued earlier, in terms of a few tangible fiscal measures, say on the fiscal tax side, a reduction in consumer (indirect) taxes may help in at least increasing the disposable income of most under the tax base. Slight tinkering with tax rates helps but more can be done to bring out the 'indirect tax cost' burden on the low-income and middle class. It may also give a much-needed fiscal space for the low-income class to save-spend more on discretion, given how much this income group has struggled through subsequent cycles of high inflation and pandemic induced misery.

Additionally, to create more fiscal space for enhanced social (and welfare) spending, the government could have introduced a more structural, 'bold' tax proposal – as a 'consumption tax' on the top 1% wealth endowed consumption group. As explained before, such a tax wasn't only needed for concerns of distributive equity (the rising gap between the rich and poor or the squeezing of the middle class) but more importantly, this would have given the Government more fiscal revenue option(s) on the direct tax end, subsequently reducing its 'spending-dependence' on increased government borrowing (which has been very high).

What about jobs and job security?

This is one area, apart from many in the social sector spending outlay, where the current Budget disappoints gravely. This author had earlier argued how vital this Budget was for the government's effort to intervene on the crisis of joblessness gripping across India.

The finance minister, much like what she has done in the past four to five budget speeches, failed to mention/acknowledge the job creation crisis ripping through sectors across India. Token announcements, like every year, were made with limited effect on ensuring good, decent jobs for the young.

If the government's effort to ensure upward social and income mobility amongst the youth is centred largely on establishing skill centres for international outreach, then we might sit on the largest 'brain drain' of educated, young Indian aspirants abroad than ever seen before. Allocative outlays for targeted job creation across sectors has been avoided by past and current budgets.

In terms of providing job security, an urban version of the MGNREGA programme, that has been the need of the hour for quite some time and advocated for by many policy economists, failed to receive any attention or mention. Even MGNREGA's own allocation for this year, announced at Rs 60,000 crore, is the lowest made in comparison to what was announced in all of previous years during this term of the Modi government.

With the current budget too, it seems the current government's own 'failed' supply side interventions that have led to 'no gain' in creating good employment opportunities for the young, , or in driving private investment opportunities (despite all the carrots provided), while barely spending on key social-welfare schemes, will continue to embark on the same path, up until the 2024 Lok Sabha Elections.

Deepanshu Mohan is director of the Centre for New Economics Studies, OP Jindal University.

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