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HOW NOT TO COUNTER ECONOMIC STAGNATION

Relevant for: Indian Economy | Topic: Issues relating to Planning & Economic Reforms

The Centre and the States are so short of resources that their fiscal deficit is burgeoning. The Prime Minister, at a function of the Associated Chambers of Commerce and Industry of India recently, was optimistic but the Reserve Bank of India (RBI) Governor was less positive, admitting that the country’s economic problems are also structural. The government has argued that its structural reforms would pay dividends in the long run. Whether or not that happens, action is needed now. So, what should the government do?

It has to give lead to the economy since the private sector, in its reaction to the slowdown, has lost confidence and is investing less, which is only aggravating the economic crisis. An RBI report suggests that business confidence, consumer confidence and capacity utilisation are down. So, there is no escaping the fact that the government has to garner resources and give a boost to the economy by increasing its investments. But the slowdown has adversely impacted growth of tax revenues.

The government calculated tax revenues on the assumption of a 12% nominal growth. But, it has been around 9%, both last and this year. So, in 2018-19, tax revenue was short by about 1.5 lakh crore. But this was not reflected in the planning for the 2019-20 Budget. Therefore, given that the base for calculating tax revenue this year was wrong and the rate of growth is incorrect, the revenue shortfall for the Centre will be even larger than last year — around 2 lakh crore.

The States get 42% of this revenue so they will get 84,000 crore less. Further, the concessions in corporate taxation of 1.45 lakh crore will also mean 58,000 crore less revenue for the States. While the Centre has obtained 1.76 lakh crore from the RBI’s reserves, no such succour is available to the States. The Centre will also get the proceeds of disinvestment but that is not shared with the States. In brief, the States will have a larger shortfall in resources than the Centre. So, what can they do?

The Goods and Services Tax (GST) Council met on December 18, where it was expected to help raise more indirect taxes by raising rates. Mercifully, that did not occur. So, revenue from indirect taxes cannot fill the resource gap. The States have also been complaining that they are not getting the funds that are due to them from the Centre. The Centre has partly responded to this by transferring more, but that raises its deficit.

The Centre is required to give the States: their share of Integrated Goods and Services Tax (IGST) and compensate them if the revenue growth of State Goods and Services Tax is less than 14%. This last is to come from the cess collected on sin goods and luxury goods. One of the big contributors to GST has been the auto sector, but with sales falling over the last 10 months collections have declined. The Centre is apparently holding back the States’ share of IGST and arguing that the cess collection is inadequate to compensate the States for their shortfall.

The dilemma is that if the GST rates are increased, prices would rise and demand would further slump, further aggravating the slowdown and shortfall in revenues. One of the suggestions has been to raise the 5% slab to 6% or 10%. It has also been suggested that taxes on petro goods and liquor for human consumption are under the purview of the States, and they can raise tax rates on these items. But these will be inflationary moves and demand would fall.

The problem is compounded by the shortfall in direct tax collections. This is both the result of corporate tax concessions and the slowing economy. Income-tax rates cannot be raised now since that would be seen as inequitable — rich corporates will pay a lower tax rate than the middle classes, who pay income-tax.

There is pressure to reduce income-tax rates to boost demand in the economy. But a cut in income-tax rates will largely benefit less than 2% of the citizens who pay a significant amount of income-tax. They are well-to-do and unlikely to increase consumption. Similarly, the cut in corporate tax rates will not boost demand since neither investment nor consumption will rise. Investment will rise only when capacity utilisation improves. Much store is being laid at the doors of multi-national corporations relocating their factories from China to India but this will be too small to arrest the current declining trend in investment in India.

The problem has been that government has been in denial and delayed action till after the Budget in July 2019. Even then it catered to the corporate sector slowdown and not where the problem originated from: the unorganised sector. The concessions to the corporate sector have narrowed the fiscal space available without raising demand.

If the unorganised sector is separately accounted for, the economy is in a recession — it is not just a slowdown as official data based only on the organised sector indicates. The fiscal deficit at all levels of government is already high so a policy decision is needed on how much more it can be. If the fiscal deficit is allowed to rise further, extra resources can be used to boost incomes in the unorganised sectors through greater public investments. In the 150th year of Gandhiji, his talisman, “last person first” is the need of the hour.

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To reassure Indian Muslims, the PM needs to state that the govt. will not conduct an exercise like NRC

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