Risks of revised estimates

How a potential fiscal deficit of 4.65 per cent of GDP was brought down in the 2019-20 revised estimates

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A K BHATTACHARYA

A closer look at the expenditure numbers presented in the Union Budget for 2020-21 offers fresh insights on how the Union government has tried to manage its finances for the current year. They also add a new dimension to the government's efforts to reduce expenditure in the current year to restrict the slippage in fiscal deficit to only 0.5 percentage point.

The need for slashing expenditure in 2019-20 was acute as the government's revenue estimates, provided in July 2019, went completely awry. Net tax revenues fell short by ₹1.45 trillion and disinvestment revenues were lower than the estimates by ₹40,000 crore. The total shortfall was ₹1.85 trillion or 0.9 per cent of gross domestic product (GDP).

In addition, there was the problem of excess expenditure under various heads like grants to Union territories, defence, the rural employment guarantee programme, pensions, relief for natural calamities, police, railways, education, petroleum subsidy and capital subsidy for space research. The excess expenditure was estimated at ₹70,900 crore.

Add this amount to the revenue shortfall of ₹1.85 trillion, you get a total additional burden of ₹2.56 trillion. This is equivalent to 1.25 per cent of GDP.

If the government had done nothing, its fiscal deficit would have widened to 4.65 per cent of GDP in 2019-20. Remember that the Budget estimate for fiscal deficit in 2019-20 was 3.3 per cent. But since the economy had slowed considerably, the resultant fiscal deficit had already gone up to 3.4 per cent.

The government in its wisdom decided against allowing the headline fiscal deficit number to be breached by more than 0.5 percentage point to stay within the ambit of the fiscal responsibility law. So, what did it do?

What could have come to its rescue was the ₹1.76 trillion of additional money that the Reserve Bank of India (RBI) was required to transfer to the Centre following the acceptance of the recommendations of the Bimal Jalan committee on the central bank's economic capital framework. But the actual additional financial bonanza for the Centre turned out to be only ₹58,000 crore for the current year.

This was because the Budget estimate for 2019-20 had already provided for ₹90,000 crore of receipts from the RBI during the year on this account. Another ₹28,000 crore had been pocketed in advance by the Centre for meeting its fiscal deficit in 2018-19 and that amount was received as interim dividend last year. The remaining amount of ₹58,000 crore was what the Centre could have got this year to boost its receipts.

But there were shortfalls of about ₹22,000 crore in dividends from other public sector banks and public sector undertakings. The net additional benefit to the Centre from dividends and profits of RBI and public sector entities was thus only ₹36,000 crore.

The extra dividends helped bring down the government's deficit from ₹2.56 trillion to ₹2.2 trillion. Another ₹35,300 crore was saved on account of reduced interest payment The government also looked at various expenditure heads and succeeded in reducing its expenditure by ₹48,000 crore, almost half of which was possible because the government could not spend as much as ₹20,630 crore from what was allocated under the Pradhan Mantri Kisan Samman Nidhi. But the gap was now reduced to ₹1.37 trillion.

It was then that the government began using the route of extra-Budget borrowing. The food subsidy bill was reduced from ₹1.84 trillion to ₹1.08 trillion, a saving of about ₹75,500 crore. This brought down the excess over expenditure to only ₹62,000 crore, which was within the safe limit of a 0.5 percentage point slippage over the budgeted fiscal deficit.

But that reduction in food subsidy was not really a reduction. The entire burden of ₹75,500 crore was met through loans from the National Small Savings Fund (NSSF). Indeed, the government borrowed a higher amount of ₹1.1 trillion from the NSSF. While ₹75,500 crore was meant for meeting the current year's food subsidy bills and the remaining ₹34,500 crore was used to settle previous year's food subsidy bills, which should have reduced the arrears of the Food Corporation of India.

What is, however, more worrying, is that the government intends to borrow ₹1.36 trillion from the NSSF in 2020-21 also to meet its food subsidy bill. Surprisingly, the government's food subsidy bill for next year is only ₹1.15 trillion and it is borrowing much more than that from the NSSF.

While for the government's 2019-20 account, the fiscal deficit has been contained at 3.8 per cent of GDP, what should not be forgotten is that these are all revised estimates. Remember what happened to the revised estimates on revenues and expenditure for 2018-19? They were presented in February 2019 and it became clear by June that year that the provisional actuals were significantly different from what the revised estimates had stated, creating fresh budgeting challenges for the government. Hopefully, by June 2020, nothing similar would take place.

CHINESE WHISPERS

Budget sparks ahead

Opposition parties on Sunday busied themselves with selecting their speakers for debate in Parliament on the Budget and also on the motion of thanks on the President's address. The government could face embarrassment on the President's speech, with the Communist Party of India (Marxist), or CPI(M), proposing amendments to it. The CPI(M) has furnished proof that the President misquoted Mahatma Gandhi on giving citizenship to Hindus and Sikhs from Pakistan. It is planning to bring an amendment, which the rest of the Opposition is set to support. The CPI(M) has verified the quote from the *Collected Works of Mahatma Gandhi*, the most authoritative source of Gandhi's speeches, statements, and writings. The Trinamool Congress has picked Abhishek Banerjee as its lead speaker on the debate on the Budget in the Lok Sabha and Manas Bhunia in the Rajya Sabha, while on the motion of thanks on the President's address, the party will field Saugata Roy and Mahua Moitra in the Lok Sabha, and Sukhendu Sekhar Ray in the Rajya Sabha. The Congress is expected to be led by P Chidambaram in the Rajya Sabha in the debate on the Budget.

Yediyurappa's dilemma

The expansion of the Karnataka cabinet on February 6 will be far from being a cakewalk for Chief Minister B S Yediyurappa (*pictured*). It has been postponed several times. Yediyurappa had made it clear that all the 11 who had revolted against the Congress and Janata Dal (Secular) government, leading to its fall, and then got re-elected in the bypolls on the Bharatiya Janata Party (BJP) ticket, will be made ministers. But sources say the central leadership is not keen on inducting all of them and wants to give old BJP hands a berth in the cabinet. It will not be an easy task for the chief minister who has to ensure adequate representation to various castes and regions in his cabinet.

Kishor's next assignment

Poll strategist Prashant Kishor will now manage the Dravida Munnetra Kazhagam's (DMK's) strategy in the run-up to the 2021 Assembly polls in Tamil Nadu. Kishor had managed the election campaigns of Prime Minister Narendra Modi in 2014, Bihar Chief Minister Nitish Kumar in 2015, and Punjab Chief Minister Amarinder Singh in 2017. He also boosted the campaign for the Jagan Mohan Reddy-led YSR Congress Party, or YSRCP, in the Andhra Pradesh Assembly election last year. The political strategist's work with the Congress for the 2017 Uttar Pradesh Assembly election was unsuccessful, with the party winning just seven seats in the state and losing all four in Amethi, Rahul Gandhi's Lok Sabha constituency then.

RBI's pause and no change in stance may continue

A rate cut or even a hike can happen, if at all, in the second half of the next financial year

BANKER'S TRUST

TAMAL BANDYOPADHYAY

The Budget of aspiration, economic development and care for all is behind us. Let's focus on the next big event — the last bimonthly meeting of the central bank's Monetary Policy Committee (MPC) in the current financial year. The Budget is its backdrop. The Reserve Bank of India (RBI) has got a new deputy governor, Michael Patra, overseeing the monetary policy department, including its forecasting and modelling unit. There is also a new member — Executive Director Janak Raj — at the central bank's rate-setting body, the MPC.

On expected lines, the Budget has revised the fiscal deficit target for 2020 to 3.8 per cent of GDP and pegged the deficit for the next financial year at 3.5 per cent. The original estimate for the fiscal deficit for 2020 was 3.3 per cent; the half a per cent rise is in sync with the so-called escape clause in the Fiscal Responsibility and Budget Management Act which, among other things, allows such a deviation in case there are far-reaching structural reforms in the economy with unanticipated fiscal implications. Of course, it mandates that such a deviation should be accompanied by a clear commitment to return to the original fiscal target in the ensuing fiscal year. For 2021, the estimated deficit target is 3.5 per cent of GDP.

There is no surprise in the government borrowing targets too. In the current fiscal, the gross borrowing target remains unchanged at ₹7.1 trillion. For the next year, the gross borrowing target has been raised to ₹8.1 trillion. It may look a bit intimidating but it will sail through without putting pressure on the bond yields. In fact, yields could drop this week.

There is ample liquidity in the system (surplus daily liquidity is currently pegged around ₹2.80 trillion, thanks to government spending) and it is fairly certain that the RBI would continue with its Operation Twist (OT) to manage the yield.

From December 2019, the RBI started conducting OT by simultaneous buy and sale of government securities. It is buying long-tenure bonds (10-year papers) and selling short-term ones (up to two years) to bring down the bond yields and flatten the curve, narrowing the term premium. The 10-year bond yield, which rose to 6.8 per cent in the recent past fearing higher government borrowing to bridge the widening fiscal deficit, closed last week at 6.6 per cent.

Just before the first round of such buy-sell auction took place, the 10-year government bond yield was 6.75 per cent. However, the 15 basis points (bps) drop in bond yield does not give the correct assessment of the impact of OT. In the absence of this, the bond yield would have risen further, inching towards 7 per cent. One bps is a hundredth of a percentage point.

OT "manages" bond yields, brings down the cost of borrowing for the government and saves banks from treasury losses. However, what we are seeing now is a combination of OT and the so-called open market operations (OMO) of the RBI as it is buying more and selling less. Through four such auctions, the central bank has bought bonds worth ₹40,000 crore but sold ₹28,200 crore. Traditionally, bond buying through OMO is done to create liquidity; this time around, the objective is clearly to "manage" bond yields. This is likely to continue to ensure a smooth sailing for the government borrowing programme without increasing the cost.

The Indian economy grew at 4.5 per cent in the September quarter, falling for the sixth quarter in a row. The Economic Survey has pegged the growth for the current year at 5 per cent and the next year at 6-6.5 per cent. The Budget estimate of growth for 2021 is more conservative — a nominal GDP growth of 10 per cent. What will be MPC's projection of growth in this round? Since February, each policy meeting, including the last in December, cut the growth estimate — overall by 240 bps, from 7.4 per cent to 5 per cent.

In December, all six members of the MPC took a call for status quo. Before that, since the beginning of the rate cutting cycle in February 2019, the MPC always cut the rate — cumulatively by 135 bps, from 6.5 per cent to 5.15 per cent.

Of course, in December it had an unambiguous forward guidance: The pause is temporary and there is monetary policy space for future action.

With further rise in inflation, one would assume the RBI would continue to be in a pause mode but there would not be any change in its accommodative stance. The future action will depend on data — both inflation and growth.

In the December policy, the RBI moved the retail inflation projection sharply upwards to 5.1-4.7 per cent for the second quarter of 2020 with food, fuel and a hike in telecom tariff contributing to it. The December retail inflation rose to 7.35 per cent, a 64-month high, breaching consensus estimates of analysts and sailing past the upper end of RBI's inflation target band (4-6 per cent). In November, the retail inflation was 5.5 per cent.

Most analysts expect the January inflation number to be way above 7 per cent and more than 6 per cent at least till March. The surge may not last for long and, in the second half of 2021, retail inflation could come down to 5 per cent and drop further.

The MPC will keep a hawk's eye on inflation but is unlikely to act at this point. An extended pause and accommodative stance are likely to continue till the growth momentum picks up. Depending on the growth-inflation dynamics, we may see a rate cut or even a hike in the second half of 2021.

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AS I SEE IT

Nehru and Sardar

A new book more or less confirms something about which there has been a lot of speculation: Nehru did not intend to make Sardar Patel a member of his first Cabinet

KARAN THAPAR

No one has ever explained why Vappala Pangunni Menon, who played a critical role in the transfer of power and the integration of Indian states in the 1940s and '50s, has been ignored by historians. There are no books or biographies on him. He's simply forgotten. Yet, this was a man who began life as a typist but rose to the very highest rungs of the civil service. Under the British, he was, in fact, the Constitutional Advisor to the Viceroy. This was unprecedented.

Fortunately, this lapse and injustice has been corrected. On the 12th, the first biography of this neglected hero will be released. Written by his great-granddaughter Narayani Basu — who also happens to be my niece — it's called *V. P. Menon: The Unsung Architect of Modern India*.

Historians will pay attention to what Narayani reveals of VP's key role in two critical areas. He saved India from the terrible balkanisation that Mountbatten's original devolution of power would have entailed. Virtually, at the last moment, the Viceroy accepted Menon's advice and the transfer of power happened in accordance with VP's suggestions. Menon also played a vital role in the integration of the Indian states. He ensured that 565 different pieces came together to create a single country. But I want to write about a different subject. I suspect it will attract greater attention in the present political environment.

Narayani more or less confirms something about which there has been a lot of speculation. Nehru did not intend to make Sardar Patel a member of his first Cabinet until V. P. Menon stepped-in and ensured the Sardar's inclusion.

The issue first cropped up 18 days before Independence. A report of a staff meeting at Viceroy's House dated 28th July 1947 says: "VPM said he was concerned about the way things were going in regard to the selection of Ministers... he had hoped that this would be a Ministry of Talents, possibly including a number of young men. However, it appeared that Pandit Nehru was having great difficulty forgetting his loyalties..." As a result, Narayani writes, "Mountbatten sent for Nehru and advised him to let go of those he was holding on to, simply because they were his old friends... 'With such a Cabinet, Congress could remain in power for the next few years', Mountbatten told Jawaharlal. 'Without it, it will be done'."

However, Nehru didn't get the message. Narayani writes: "In the first week of August, Nehru submitted his official list of the people he wanted to serve in independent India's first Cabinet. The list should have been headed by Sardar Patel. It wasn't." This is when VP got into action.

Relying on his tape-recorded interviews to Harry Hodson, which are part of the Hodson papers at the School of Oriental and African Studies, Narayani writes: "When news of this reached VP, he was aghast. 'I went straight away to Mountbatten. I told him if you do this, you will start a war of succession. Congress will be split in two. Have no doubt about it... So, Mountbatten went to meet Gandhiji and as a sop, Sardar's name was finally included'."

The Hodson papers also carry interviews with Mountbatten that confirm this. "Now, to be honest, this story does ring a very faint bell with me," Mountbatten told Hodson. "I have a feeling that this was such a very hot potato that I probably just mentioned this to Nehru at tea time and made a point of not recording it anywhere and probably not even of passing on the story."

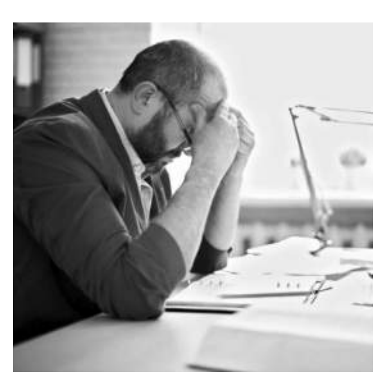
It's hard to believe Nehru contemplated excluding Patel from his government but that does seem to have been established by Narayani. "Mountbatten's correspondence with Hodson provides sufficient corroboration of VP's assertion that Jawaharlal, whether out of spite or fear of the Sardar, intended to exclude his only potential rival — and the one person who could govern India better than himself — from the Cabinet."

However, Narayani's book goes one critical step further. She also writes VP believed "Nehru had begun a sustained and deeply calculated move to whitewash Sardar Patel from public memory... an allegation he stood by until the end of his life. 'When he (Sardar) died, a deliberate campaign was begun to efface his memory', VP asserted. 'I know this, because I have seen it...'."

Now, if only Nehru could respond.

LETTERS

Utter disappointment



The Budget is a disappointment. The Indian economy has been spluttering for the last two years. GDP growth rates have declined from 8 per cent to about 4.5 per cent. Unemployment is running high at 6 per cent. Consumption is falling in every sector; be it cars, houses, two-wheelers etc. Companies are laying off workers in large numbers. It was thus widely expected that the Budget would be dynamic and lead to demand and investment revival. Unfortunately, the finance minister has presented a pedantic Budget, which will not provide the desperately needed stimulus to the economy. The Sensex fell by 1,000 points underscoring the lack of confidence in the new Budget proposals. A golden opportunity to boost the economy and provide jobs has been lost.

Rajendra Aneja Mumbai

Unrealistic estimates

No Budget can meet all its projections, nor can it satisfy all sections given that it is only an estimate of interdependent revenues and expenses, based on which the economy is slated to achieve certain parameters during the next year. In the Budget presented by Nirmala Sitharaman, a fiscal deficit of 3.8 per cent of the GDP, is inevitable, considering the need to step up consumption and investment to stimulate growth in a slowing economy. Other estimates, such as 20 per cent increase in capital expenditure and a 15 per cent rise in revenue spending are optimistic, though the tax collection targets and those set for revenues from disinvestment and non-tax revenues seem to be unrealistic. Also, the marginal increase in defence outlay is disappointing considering the need to maintain a lean and mean army in a state of perpetual readiness. The IT relief provided to the salaried class and raising the insurance cover of bank deposits to ₹5 lakh per bank customer is a big relief to depositors, especially senior citizens. As always, despite the laudable intentions, the extent to which the Budget projections are achieved will be known only as the fiscal year unfolds.

V Jayaraman Chennai

More complicated

If the intention was to simplify individual tax rules, the finance minister has achieved the opposite. It is ridiculous to have two tax regimes, when even one was confusing enough. That has actually provided more fodder for chartered accountants and tax consultants. There should be a straight migration to a non-exemption regime, with no ifs or buts. And we could have a tax free slab of ₹10 lakh and reasonable rates for just four slabs. All your income could be included. No exemptions, including housing loan benefits, LTC, medical (except hospitalisation), contribution to any scheme like PF, PPF, insurance etc should be allowed to be deducted. Only interest from schemes with a long lock in such as PPF can be exempt.

With such a simplified tax, compliance and administration will become much easier. The income tax staff freed can be diverted to track GST leakages and avoidance. The FM has also not made it clear whether any of the exemptions in the old regime will be removed or reduced. Further can we migrate from regime to regime as and when desired? If not then this is a sword of Damocles hanging over our heads and would adds to the vagueness of our tax structure.

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