

## **KEY PRIORITIES FOR THE BUDGET**

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All of us who are invited to the pre-budget meetings with the Finance Minister and his team of senior finance ministry officials must have at some stage wondered about what happens to their suggestions. I know that industry organizations do a count of suggestions that have been accepted if only to impress their membership. Economists and other sundry experts should perhaps also attempt such a tally if only to recognize the gap between their understanding and that of the political leadership on what looks worth doing and doable. The finance ministry can do us all a great favour by sending a list of all the suggestions received during these meetings to all participants. It will be interesting to see how many suggestions get repeated over the years and for how long. Some researcher could one day even discover patterns and correlations between the suggestions and the probability of them being incorporated. Here is a list of what I think should find a place in this year's budget, and of course like all others, I am hoping that some of these will be reflected in the budget.

The Finance Minister (FM) will do well to start his budget speech with a medium term outlook for the economy and of the fiscal situation over that period. He would then be able to locate the present budget in that medium term context and as suggested by one of the most seasoned and experienced economist, he should give an assurance that the basic features of his fiscal policy or approach like the direct and indirect tax rates, expenditure allocations and trends will remain unchanged except in an emergency. This will resurrect the medium term fiscal strategy which has now been relegated to the appendix.

It will also be important for the FM to reiterate his commitment to fiscal discipline and lay down the path for going back to FRBM targets over the medium term. In doing so, he will have to redefine 'revenue expenditure' to make it net of outlays on education and health. These outlays are now almost universally recognized to be essential components of overall capital formation as they contribute to the building of human capital which is equally if not more important than physical capital for achieving rapid and inclusive growth. It is prudent and not old fashioned to insist on bringing this "pure revenue deficit" down to zero as quickly as possible. Borrowing to spend on salary and wages and current consumption is simply bad policy.

To regain fiscal balance some effort at additional resource mobilization will have to be made and in this context 'tax pessimism' is not warranted. In fact the tax to GDP ratio can be raised further because if we compare our tax to GDP ratio with emerging Asian economies (and not with all emerging economies that includes Latin American and African ones) where the State has played a more active developmental role, then India does not appear to be an outlier. Our tax to GDP ratio currently (combined Center and States ) is 16-17 %. Malaysia, China, Taiwan, Korea all had similar ratios at per capita income levels that we have today.

And we can safely assume that India's GDP is substantially understated and so the real tax to GDP ratio is in effect much smaller. To raise the tax-GDP ratio, he will have to substantially simplify both direct and indirect tax structures. In the case of direct taxes, there is little if any justification for keeping all the exemptions and cesses and special charges in place. These can all be quantified and merged with a single tax rate for both personal and corporate income tax. At the same time he should extend the direct tax net to cover all the services including legal services which his predecessor thought should not be covered because lawyers, according to him, did not add value in rendering their services!

I have always wondered about the actual reasons for which we don't have any Estate Duty or inheritance taxes in India. This is a very progressive tax as it significantly weakens the incentive for accumulating wealth, discourages rentier incomes and encourages people to earn a living. The FM should leave the present indirect tax structure, with its rates lowered as response to global economic downturn, largely untouched. High indirect taxes make our industries incompetent and also prevent domestic demand from becoming large enough for the industry to benefit from economies of scale through which the firm can also generate exports.

The proposal for smart Cards for PDS beneficiaries was submitted to the Ministry of Finance three years ago. While there has been some initial work, the proposal which has the potential merit to empower the actual beneficiaries and minimize corruption in related departments has not been implemented. This Smart Card should not be linked to the issuance of National Identity Card because its objectives are completely different. It will put real purchasing power in the hands of the beneficiaries, save costs and cut out large scale leakages

Finally, the FM should resist granting any more fiscal sops for exporters until the entire existing system of export promotion is thoroughly reviewed and revamped. Export promotion councils, federation of exporters, duty draw back schemes have demonstrably had hardly any impact on building real competitive strength as can be seen by India's share in world exports of goods and services remaining at about 1 and 2.5% respectively. It will be more effective to simplify the export procedures and clearances and lower transactions costs than to continue with the current regime. The FM should only thereafter announce a scheme under which export councils will receive payouts, which they could share with their members, once their sector exports achieve a certain minimum share of world markets.