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Say no to a tax cut this Budget



In case growth does not pick up, tax cuts can be announced later and not necessarily on February 1

The Reserve Bank of India (RBI), the International Monetary Fund (IMF), the Asian Development Bank (ADB), Moody's and many others have slashed India's GDP growth rate forecast, indicating their pessimism at the sluggishness gripping the economy. Renowned economists recommend renunciation of fiscal prudence to buoy consumer confidence, though a lot has been done already. What more can the Finance Minister do to lift the \$3-trillion economy through a small lever called 'the Budget'? Coming to power in 2014, the NDA claimed to have embarked on the path of detoxifying the economy. GDP grew faster initially, but growth deceleration began from Q3 of 2018. Since then, gloom has prevailed and doom has been predicted. The year 2019 saw unprecedented efforts by the Centre to revive the economy. Corporate tax was lowered to an unprecedented 22 per cent; repo rate was reduced to a whopping 135 basis points; GST rates were cut substantially; tax benefits were extended to individuals; and the government made enormous an effort through spending. Government spending is estimated to grow around 10.5 per cent by the end of FY2020. No other component of GDP is growing by this proportion.

People expect further tax cuts to be announced in the Budget. Actually, there has been no Budget where the public did not desire tax relief. So, should the Finance Minister oblige and reduce taxes further? This does not seem advisable.

The multiplier effect

Some economists believe that the fiscal deficit has already reached around 5.5 per cent. A CAG report has shown concern on the rising debts of PSUs. The government has not reimbursed the subsidy amount to fertilizer companies. The Centre is short of funds while it still needs to spend a lot on power distribution, health, roads, education and skill-building, tourism, the national agriculture market (eNAM), cold storage facilities, logistics and Defence. Reduced tax revenue will restrict government spending in these critical areas and could have a deleterious cascading effect on the economy. There are signs of the GDP growth decline bottoming out. GST collections in November and December bounced back to above ₹1 lakh crore levels. The Index of Industrial Production (IIP) too went up by 1.8 per cent in November 2019, after recording a hat-trick of negative growth in August, September and October. Purchase Managers' Index at 52.7 in December 2019 is highest since May 2019. Biscuit-makers Parle and Britannia made news about falling demand in rural India but Mondelez, India's number one chocolate-maker, experienced demand taking off elsewhere. It is reported to be investing a big chunk of \$150 million this year in rural India. Kantar Worldpanel, a global consumer research firm, stated that the Indian rural market grew 4.4 per cent by volume during July-September 2019. The previous year, it had declined 2.4 per cent. Unbranded products grew at the cost of listed companies' products, the sales of which largely plummeted. Consumer behaviour changed and packaged products demand fell in the rural areas, as per Nielsen data.

Financial irregularities

Microeconomic problems can't be sorted out by macroeconomic solutions. When inventory was piling up for Suzuki, Hyundai, and Mahindra & Mahindra, ironically new cars from MG Hector and KIA were in hot demand. MG Hector even looks to be setting up another plant to ramp up production. Bharti Airtel's value-eroding plan to invest in Africa is a microeconomic decision. The telecom industry's misery is not due to macroeconomic factors. Instead, microeconomic issues have dealt it a deadly blow. NBFCs faced liquidity issues despite repo rates being lowered in quick succession. Financial irregularities at IL&FS and many other commercial banks are well known. As per the recent RBI report, domestic banks in India reported a 74 per cent jump in the value of frauds — ₹71,543 crore in FY19 from ₹41,147 crore in FY18. Public sector banks account for over 90 per cent of these frauds by value. Top leadership at Yes Bank, ICICI, Syndicate Bank, PMC Bank, PNB, Axis Bank, Indian Bank, SBI and Corporation Bank have been probed, and some penalised for irregularities. As the banks gear up to take measures to curb this menace, loan approval time and cost of servicing loans may increase. Commercial banks thus continue to charge high interest rates and credit growth remains slow, at 7.08 per cent as on December 12, 2019. Deposit growth has been 10.09 per cent. With the RBI's intervention and recapitalisation of PSBs, the rot in banking and NBFCs has been eliminated to some extent. Sanjiv Bajaj of Bajaj Finserv, talking to CNBC on the side-lines of the Davos WEF meet, mentioned that sentiment among the SMEs and NBFCs has improved significantly in the last four-five weeks. So, credit growth may accelerate now without the carrot of lower tax rates.

Are tax cuts really the answer?

Generally speaking, tax cuts are likely to be viewed as temporary. If people save the increased disposable income, the fiscal deficit will shoot up. Exodus of capital from India, leading to a sudden fall in rupee, may be seen. The country's sovereign rating is quite likely to fall in such a situation. India can't afford a fall in rupee value and sovereign rating, which will escalate import costs and foreign fund costs. The FM needs to wait and assess the impact of expansionary steps taken earlier.

In case growth does not pick up, tax cuts can be announced later. February 1 is just a date, tax cut announcements can be made, and have been made, on many other days. Gita Gopinath, Chief Economist at the IMF, may have expressed pessimism, but IMF Chief Kristalina Georgieva exuded confidence as she said: "We had a downgrade in one large market, India, but we believe that's temporary. We expect momentum to improve further, going ahead."

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