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What to expect from the upcoming budget

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The upcoming budget for 2017-18 will cover the last full financial year before the general elections. There will inevitably be some elements of populism, which is not always bad since political incentives sometimes coincide with genuine public interests; but this budget also provides a chance for the government to be seen to consolidate the economic achievements that are claimed to have been achieved. In the later respect, not much seems to be in the offing.

The expectation of high GDP growth along with continued macroeconomic stability may have led the policymakers to be in a relaxed mood of business as usual, notwithstanding some ominous signs in the slowdown of export growth and a decline in remittance flows. While most of the discussions on the budget have been bogged down in the VAT controversy, the crying needs for transformational reforms in the economy remain ignored. Deep reforms are overdue to deal with the continued erosion of discipline and integrity in the financial sector, lack of a congenial investment environment leading to huge illegal fund transfers abroad, huge tax evasion, and the cost and time overruns of public sector projects.

The national income statistics for the last few years show that our gross national investment has fallen short of gross national savings, let alone savings plus net foreign aid that together represent the total supply of investment resources. That is an indication of a serious problem with investor confidence - an issue better left for analysis by experts in business psychology. Why, for example, do many of our business entrepreneurs have to live a dual life with part of their accumulation kept abroad instead of being invested in the country?

There is much to be done in improving the planning and implementation of public sector projects - particularly the large infrastructure ones - regarding cost control, technical design, environmental assessment, and credible economic evaluation. Availability of suppliers' credit, lobbying of interest groups and geo-political considerations will of course play some role, but these should not be the only determinants in decision-making for such projects. While undertaking new infrastructure projects may seem politically attractive - be it high-profile national projects having prestige value or local projects satisfying electoral constituencies - the maintenance of existing infrastructure gets far less attention. Spending for maintenance can yield much higher returns than that on new projects. Investing on elevated highways, for example, would not contribute much to improve transportation if the roads underneath becomes unusable because of lack of maintenance.

The controversies regarding the projected GDP growth rate is another unnecessary detraction from the substantial issues of economic management. The GDP growth rate is not the best indicator to judge the current economic trends. One should rather look for other readily available and more reliable indicators, like the export and import trends, number of containers handled at the ports, remittance inflows, growth in credit and money supply, etc. The current trends in these indicators do not indicate as much dynamism in the economy as would be suggested by the projected GDP growth rate.

The proposed introduction of the new VAT law has been in the centre of controversy in the budget discussions. In short, the new law proposes collecting VAT at the full rate, and not at a truncated rate, from the retail and wholesale businesses, while allowing for deductions for the VAT paid at the earlier stages of value chains. The main problem with VAT arises from its poor compliance, resulting in the vast majority of tax-eligible businesses currently lying outside the VAT net. This is the reason why a large part of VAT collections come from only a few items, some of which are widely used production inputs like gas, power and cement. Being an indirect tax on consumption, VAT should be collected as far as possible at the sale points of consumer goods and services. It is because of the reliance on VAT collections on intermediate goods and production inputs that the need has now arisen for the complicated process of keeping records and claiming deductions at various stages of the values chains.

The new VAT law may have various effects depending on how well the law is enforced. The non-compliant businesses may now try to pass on the full VAT on prices without actually paying the VAT; some of the compliant businesses may now pay the full VAT without claiming deductions because they are unwilling to show their entire business accounts, or they lack capacity for appropriate record-keeping or they procure from non-VAT-compliant businesses; the small businesses paying turnover VAT may be at a disadvantage in selling their wares to VAT-compliant stores, who may not be able to claim deductions on such purchases. In the absence of any rigorous analysis of how all this will work, the likely impact on prices and tax collection remain anybody's guess. Consequently, much of the on-going debates between the business community and the tax authorities have been rather in the nature of shadow-boxing.

The government policymakers seem to be, however, responsive to some of the genuine concerns and suggestions coming out of the pre-budget consultations. They are reportedly trying to find ways of emphasising the maintenance of existing infrastructure alongside investing in new projects. The emphasis on payroll taxes on the salaries of employees as a major source of income tax revenue, which is an outcome of last year's pre-budget discussions, is likely to continue. Another issue is making the transfer prices of apartments more realistic, so that a genuinely tax-paying seller is not left with unexplained income beyond what is shown in the registration deed. The VAT on the sale of apartment, which is investment rather than consumption, may be withdrawn for low-cost housing. For the relief of low-income consumers, the list of items for VAT exemptions is reported to have been widened. And there is also some thinking about how to increase allocations for social spending on health, education and social security, as befitting for an aspiring middle-income country. To the credit of the Finance Minister, the often heard allegation that the pre-budget consultations are merely a ritual not to be taken seriously is not entirely true.

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