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Budget 2017-18 priorities

Getting an agreement on GST should be the main concern for the government, not demonetisation

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The finance minister will present the Budget for 2017-18 in an economy reeling under the hammer blows of the demonetisation exercise, a sharp fall in consumer and business confidence, a continuing slowdown in corporate investment, slow growth in global trade and an environment unfavourable for inward capital flows.

With the elimination of the Plan and non-Plan differentiation and new formats for the expenditure proposals we can expect some changes in the cosmetics of the Budget. These may help to hide the underlying blemishes, like, say, slowing of public investment growth. The recommendations of the Fiscal Responsibility and Budget Management (FRBM) Committee and the Fiscal Year Committee will presumably also find their place, unless of course they do not fit in with the government's political priorities.

This is a likely possibility if the widespread press expectations of tax cuts and boosts for populist programmes to dampen the adverse political impact of the demonetisation travails are correct. These giveaways are supposed to be financed by additional government borrowings against the burgeoning deposits in the banking system engineered by the demonetisation scheme. This will obviously hit the FRBM deficit constraint and hence the scepticism about the impact of the FRBM Committee on the Budget.

What we will probably not see in the Budget is the long-awaited start of the goods and services tax (GST) due at least in part to the political acrimony engendered by the demonetisation exercise. This is a setback to the reform process and a huge price to pay if the outstanding differences are not resolved before the September deadline.

So much of what we can expect. But if the finance minister is allowed to move beyond political damage control and focus more on economic damage control what should he do?

The first and most important priority should be to restore consumer and producer confidence in the stability of policy. Today producers are holding back because of the disruption of payments systems and the decline in consumer demand. Consumers are holding back because they do not know what new prohibition or regulatory or reporting requirement may emanate from the government. The frequency with which the rules about old note surrender and new note issue have been changed (including the latest one limiting old note deposits to ₹5,000 even before the December 31 deadline) have created uncertainty in people's minds about what the Government will do next. This is the case not just with the ones who have something to hide but law-abiding wage and salary earners. Hence the need for a clear announcement scotching rumours of further actions that would hit not just illegitimate but also legitimate transactions. Please no more half-baked *dhamakas*.

The government has started projecting the poorly planned November 8 *dhamakas* as an attempt to promote cashless transactions. Incidentally these involve a cost in the form of charges levied by the payment portals and card issuers which is absent in a cash transaction. Of course, carrying cash around involves the risk of theft or loss; but so do digital payments through banking and card frauds.

The government's attempts to promote digital payments include temporary incentives to reduce the cost of cashless transactions and, gimmicky prizes for the use of RuPay and a few other specified means of digital payments. Recently, the head of the State Bank of India suggested a levy on high-value cash transactions with no explanation on how such transactions can be brought within the tax net. Most high-valued cash transactions take place because the buyer or the seller or both are trying to evade taxes on the transaction or hide some income from the eyes of the taxman. Political funding is a similar case. Why don't the BJP, Congress and other parties announce a unilateral commitment to take contributions only through cashless formal channels?

Apart from banking channels the government is pushing hard for digital payments which require a secure, reliable and effective communication network. Today the state of our mobile phone network is such that we often have to rush out to an open space to receive a call. Call drops are also frequent. The coverage goals for the optic fibre network have slipped badly. The risks of losing data to hackers is high. In this sort of communication environment, the risks of aborted payments, misdirection and fraud are high. So, one must tell the *dhamaka* masters in government — get your priorities right. Focus first on building up a reliable system for cashless payments before you put in mandatory restrictions on the use of cash.

The one thing that would have generated a sustained incentive for the use of formal payment systems through banks and payment portals is the GST. Businesses in the GST net will have to load transaction-wise data to claim set-offs for tax paid on purchases and that will incentivise even small businesses to use formal payment mechanisms for business-to-business transactions. The retailer or wholesaler compelled to use the formal system for goods supplied will have a strong incentive to deny buyers the option of unbilled and untaxed sales. Hence the incentive for consumers to use digital, card-based or cheque payments will be enhanced. More can be done through Aadhaar-based direct benefits transfers to households of some small proportion of GST paid as a promotional incentive.

GST, even in its present less-than-ideal form, is a much bigger game changer than demonetisation. The correct sequence of action should have been first, push GST through and then use its procedural requirements to promote cashless payments systems. After that, hit the cash transactions economy with demonetisation in the true sense where high-value notes are not replaced, but eliminated altogether.

Getting an agreement on GST should now be the main reform priority for the government. If this requires the Centre to give way on jurisdiction issues — just do it. If it would be helped by suitably mollifying Mamata*didi* — just do it. The impact on business confidence will help to put the pain of demonetisation behind us.

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