Budget 2017

The Good, the Bad, & the Ugly

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Fiscal Consolidation

- Most urgent priority from a macroeconomic perspective was fiscal consolidation.
- The 2017 budget is a lot more realistic in terms of revenue targets and expenditure expectations.
- From a deficit of 7.4% in 2015, to projected deficits of 5.4% in 2016 and 4.6% in 2017 – the fiscal consolidation path is established.

Revenue Trends

- Increases in income taxes are part of a desirable shift towards more direct taxes.
- A number of tax incentives rationalised – could be detrimental in the ST to those sectors.
- But taxes should not be seen as an incentive tool but as primarily as a revenue instrument.

Revenue Realism

- Expectation of a significant improvement in revenue administration – particularly for income taxes.
- Along with revenue base increase through 6.3% real GDP growth and 4% inflation.
- Potential over-estimates in revenue collection from import based taxes and excise duties – particularly with lower vehicle imports in 2017
- On aggregate – revenue targets are not unrealistic and could be met with positive admin improvements.

Expenditure in Check

- Recurrent expenditure projected to grow at 10%
- Overall expenditure to grow 17% - with a big increase expected in capex
- 42% capex growth is unlikely to materialise and will likely see cuts if revenue expectations are not fully met.

Borrowing Strategy

- 2017 is likely to be another volatile year for emerging/frontier markets.
- GoSL planning less borrowing from foreign commercial sources
- Increase in domestic borrowings driven by expectation of positive inflows from foreign investments in LKR GovSec.
- This would depend on global capital market appetite.
- Opportunity to consolidate fiscal position in preparation for external repayments from 2018.

Likely Macroeconomic Implications

- The more pragmatic deficit target will ease govt borrowing requirements
- Should enable interest rates to remain around present levels till H1 2017 and ease in H2
- Demand will be subdued due to higher direct and indirect taxes – weaker consumption and modest economic activity.
- Imports likely lower and current account stable – supportive of LKR value.
- One-off hike in inflation in 2017 due to tax changes – but limited to 6-7%

Export Orientation

- Trade facilitation measures – supportive of both imports and exports
- Phasing out of ad-hoc charges such as cess is a positive
- Exim bank not implemented in 2016
- FTAs with key markets in emerging Asia is a positive
- Easing of foreign investment in land – supportive of FDI
- SVAT – short term challenge, particularly in early stages of RAMIS implementation

Education & Skills

- Speech refers to investments in curricula development, teacher training etc. – but few specifics
- Focus appears to be more on investment in physical infrastructure than on reforms per se
- References to enabling greater private supply of higher education is a positive

Finance

- Numerous Central Bank policy areas referred to in the budget
- Capital requirements can help consolidate the banking sector
- Directed bank lending is less desirable
- Positives with regard to listing of SOEs

Digitalisation & ICT

- Digital ID can help with targeting of subsidies etc. but privacy must be addressed
- National Payment Platform to be implemented by ICTA – requires clarification of role of CB
- Continued heavy taxation of telecom services

Largely Good, Not So Ugly

- The commitment to fiscal consolidation is a relief from a macroeconomic stability perspective.
- A fiscal expansionary budget would have had disastrous outcomes particularly in the present volatile external economic context.
- The increased taxes will deflate economic activity in 2017 and it will be a challenging year for business – but this was necessary from a macro stability perspective.
- Fiscal consolidation needs to continue to stabilise the fiscal position in time for large external payments from 2018.
- Need to further streamline government recurrent expenditure driving efficiencies in procurement, human resources etc.
- Prioritise spending on reform of education, enhancing public service quality and efficiency, and smart regulation.

A Case for Re-orienting the Role of the State

- State sector today plays a huge role in the economy – 245+ state owned business enterprises, 1.3 mn + employees, dominant role in certain business sectors.
- Uses up scarce resources and is expensive to maintain such a large government – particularly in the context of relying on external commercial borrowings.
- The role of government should re-orient to one that creates an environment for private enterprise to compete to allocate scarce resources to its most productive use.
- The state should create the institutional rules based framework to enable this – and address market failure not by replacing the market but through smart, unobtrusive regulation and targeted interventions to address issues of social justice.

Thank You

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