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India Budget 2016 and the Indian Economy

India's Union Budget 2016 has been criticised for lacking big bang reforms, or not actively promoting industries and, instead, being largely pro-rural and agricultural sectors. This paper throws light on some aspects of the budget which are small steps towards improving the business climate of the country, keeping in mind the constraints, advantages and vision of the present Union Government. The major points presented here are largely derived from a panel discussion organised by the Institute of South Asian Studies (ISAS) in Singapore on 3 March, 2016. The panellists were Mr Vinod Rai, Dr Jehangir Aziz, Mr Rohan Solapurkar, Mr Vikram Khanna and Dr Amitendu Palit.

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India's annual budget attracts attention from the media as well as intellectuals from the policy circle and academia. The recent budget 2016 was no exception. All budgets are evaluated by experts largely analysing the effects on a) providing impetus to India's long-term economic growth or infrastructure development, b) improving the business climate for foreign and resident investors, c) poverty reduction d) taxes & subsidies and e) Fiscal deficit targets. In this paper, the same analysis is attempted, keeping an eye on the constraints and advantages that

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the government enjoyed in the recent past, its commitments to the Indian electorate and its vision for India's future.

To brush through the macroeconomic fundamentals of the Indian economy just before the budget, as of January, 2016, India had a Consumer Price Index (CPI) inflation rate of 5.6%.[2] India's current account deficit stood at about 0.7% of GDP in 2015 with foreign exchange reserves at US$ 350 Billion.[3] Increasing levels of non-performing assets (NPAs) of public sector banks have seen the impaired assets of public sector banks touch INR 7 Lakh Crores, with the ratio of stressed assets to total loans of Public Sector banks touching 15% in June 2015.[4] While the global economy faced a gloomy period, because of slackening global demand, India was singled out as a "bright spot" by the International Monetary Fund (IMF). However, India faced two consecutive years of poor monsoon and hence the agricultural sector has been under stress. On most of these counts except for the weak monsoon and the NPAs, the Indian economy was in a more favourable position vis-a-vis the previous budget season where the Finance Minister had played to the Fiscal deficit target of 3.9% of GDP in comparison to the prescribed target of 3.5% according to the Fiscal Responsibility and Budget Management (FRBM) Act.

In the current situation, the government finances have been put under greater pressure due to the increased fiscal expenditure for the One Rank One Pension (OROP) scheme, the recommendations of the 13th Finance Commission which allocated only a share of 58% of Central Taxes as against the earlier 68%, as well as the recommendations of the 7th Central Pay Commission. Apart from these challenges, the government's own focus areas include the "Make in India" initiative which requires (amongst other things) an improvement in the business atmosphere, improving employment prospects for India's large pool of semi-skilled to low-skilled labour force, infrastructure development and incentives to foreign investors. Hence, in analysing the budget, one has to see how the announcements in the budget relate to the global situation and domestic challenges and aspirations of the government. The crucial challenge is to address the goals and yet maintain a 3.5% fiscal deficit target. Given the

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[2]Statistics sourced from the Database on Indian Economy, Reserve Bank of India

[3] Sourced from indiabudget.nic.in. Most statistics in this paper unless otherwise specified are sourced from indiabudget.nic.in.

[4] See "Public Sector Banks' stressed assets stymieing overall economic growth" 22 February, 2016, *The Hindu* http://www.thehindu.com/business/public-sector-banks-impaired-assets-stymieing-overall-economic-growth/article7955262.ece

performance of the ruling party in the recent sub-national State elections and in view of the impending elections in some more states, the FM was not in a position to do anything that was politically untenable.

In the previous year, one of the biggest advantages the government has had is the dramatic fall in oil prices. One would have expected that in response to this decline, prices of petroleum products would have declined, leading to a spurt in economic growth. However, India grew at a rate of 7.6% only (keeping in mind the warnings on the methodology of calculation of the GDP which was altered recently). Domestic oil prices did not see a commensurate reduction in response to the global fall in oil prices. In effect the gain went to the Central Government from the public sector oil companies. While this strengthened the government finances, the country compromised on immediate economic growth. One may question as to why the government did not use the funds for more effective growth-stimulating initiatives by transferring the benefits of the global fall in oil prices to the Indian consumer that would push demand. In the past, the government had tried to push growth through immediate fiscal stimulus which has not led to desired effects. In fact past attempts to improve the economy through greater government spending has led to greater balance of payments problems in the wake of an unchanged savings and investment scenario through the twin deficits hypothesis.

Concentrating on the larger picture, one understands that public investment is not a problem at present for India. It is the private investment which needs to pick up. In the last few years, most projects have been stalled, and the banks are currently finding it difficult to finance further projects due to a rising NPA problem. A key reason behind the lack of corporate investment is the lack of demand. While globally demand is poor, India has one of the highest savings rates in the world stemming from high uncertainty in two sectors, namely: health and education. India's middle class dreads the sky-rocketing expenditures that might hit them for a family health problem as well as the kind of expenditures that may be required for their children's secondary and higher education. Both these sectors have remarkably low levels of public investment compared to global standards. The budget has made an attempt to address health and education requirements for the economically vulnerable sections and at a general level. One may hope that these act as the stepping stone to reducing economic uncertainties and drive domestic consumption growth.

Employment creation and skilling of individuals for the world job market is another key area where the government needed to address challenges. The budget has allocated INR 1,804 crore towards skill development investment and committed towards setting up 1,500 multi-skill training institutes. While the announcement is encouraging, one also notes that most of the country's top institutes are plagued by the paucity of quality faculty members and even the Industrial Training Institute (ITIs) are struggling to recruit efficient trainers who would impart skills to individuals. Employment of students from these institutes has also been a problem. New job opportunities may also come with higher investment from domestic and foreign investors. The government has proposed paying a contribution of 8.33% for all new employees enrolling for the Employees Provident Fund Organisation (EPFO) for the first three years of their employment with a budget provision of INR 1,000 Crore for this scheme. This eases the burden on companies and should help improve employment and job creation.

There were several announcements in the budget pertaining to taxes which could be mapped to the easing of doing business with stimulus to the "Make in India" and "Start-up India" campaigns. These are a) Simplification and rationalisation of the Tax rates, b) Equalisation levy, c) 10% Income tax on Patents developed and registered in India by residents and exploited globally and d) Amnesty Scheme for resident Indians to mop up black money.

Simplification and rationalisation of tax rates have been announced. New initiatives like abolition of 13 cesses by various ministries in which revenue collection is less than INR 50 Crores per year, implementation of customs single window project at major ports and airports, provision of deferred payment of customs duties for importers and exporters with proven track record etc. are very helpful to improve doing business indicators of India.

The option of availing a tax rate of 25% for new domestic companies incorporated after 1 March 2016 in addition to cess leads to total taxes of about 28% in place of the 34% which the older ones require to pay. This benefit has been provided to the new companies and not the old ones if they do not claim deductions linked to profit or investment and do not avail accelerated depreciation or investment allowance. Undoubtedly, this incentivises new companies. Amongst other benefits for the start-ups, 100% tax deduction has been announced on profits for 3 out of 5 years if the start-up registers between April 2016 and March 2019. All income generated through patents developed and registered in India would be taxed at the rate of 10% which is a reduced rate. This gives a push to the "Make in India" initiative that the government

had launched inviting companies to operate their Research and Development (R&D) centres in India.

The equalisation levy of 6% of gross amount for payment made to non-residents exceeding INR 1 Lakh a year in case of B2B transactions helps the government mop up previously untaxed revenues of foreign firms.

Black money disclosure scheme for resident Indians has been attempted where disclosed money would be taxed at an approximate combined rate of 45%. Previously a scheme was tried for NRIs which would tax the disclosed funds at a rate of 60%, but it was not successful. The new scheme allows resident Indians to disclose and pay a tax and avoid further prosecution.

The fundamental problem remains that of raising investments. The government has given positive signals. First announcement is 100% FDI in food products manufactured and marketed in India. This is a sector in which India has improved its exports in the recent past. Second, the budget announces revamping of the land records modernisation programme. This would help streamline the property rights for land through appropriate title deeds helping buyers to know how to go about acquiring land. Third, the Motor Vehicles Act may give greater space to private cars used commercially. Fourth, infrastructure projects will be credit-rated allowing investors and banks to make safer judgements and avoid obvious cases of bad loans.

The budget was not bereft of disappointments. The INR 25,000 crore allotted for recapitalisation of public sector banks is a significantly low amount given the huge burden of NPAs these banks are currently handling. A second discouraging move is the tax on 60% of retirement funds. This announcement has been deferred by the government until a comprehensive review is done.[5] The Prime Minister has set a target of doubling rural income by 2022. This implies a 14% increment annually for farmers' income. The only perceivable way this may be done by the government is through the Rural Employment Guarantee Act, which is a less-than-easy task. Finally, the FRBM Act may be reviewed as announced by the Finance Minister. This raises doubts about the commitment of the government towards fiscal discipline in future leading to fears of enhanced spending creating an untenable fiscal deficit.

[5] See "Arun Jaitley rolls back proposal to tax EPF withdrawal" *The Times of India* http://timesofindia.indiatimes.com/india/Arun-Jaitley-rolls-back-proposal-to-tax-EPF-withdrawal/articleshow/51304022.cms

In sum, while the budget has been said to be pro-rural, the government has taken steps to ease doing business and facilitate start-ups in the country in line with its vision and the immediate requirement to entice investment and promote employment. In the face of the criticism that there are no big bang reforms in the budget, one may point out three bigger initiatives which the government has been intending to enact through Parliament amidst tough opposition. These are the Goods & Services Tax (GST) Bill, the Land Acquisition Bill and the initiative to legislate insolvency and bankruptcy laws.

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