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Indian Budget 2021-22: Focus on Reform and Divestment

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Summary

The Indian budget for fiscal year 2021-22 has done a remarkable balancing act in providing funds for critical sectors and focusing on long term reforms which had been pending for several years now. Spending on infrastructure is designed to create a multiplier effect. The creation of appropriate institutional support to cater to the reform agenda and divesting public enterprises has received priority. Adequate allocation for health and capital expenditure in defence has been ensured. Possibly, most heartening, is the attempt to inject transparency in the budget exercise by appropriately displaying subsidy figures. The success, as always, will be in the implementation of these announcements.

India's Finance Minister, Nirmala Sitharaman, certainly had a very unenviable task in delivering the budget this year. The competing demands on the budget were huge. Resources at her command were severely limited. Nevertheless, she has been able to deliver a budget which meets the requirements of the nation. The budget has ensured provision for all critical sectors. Additionally, it introduces a bold reform agenda in the banking and insurance sectors. There is an attempt to target long term reforms through privatisation, increased foreign direct investment (FDI) and opening certain sectors to private equity. The push given to infrastructure creation, monetisation of government assets, divestment of public sector enterprises, setting up of a 'bad bank' as well as a development financial institution, and increasing the FDI limit in the insurance sector from 49 per cent to 74 per cent, are some of the bold steps announced.

In terms of its structure, the budget has embarked on a positive shift towards greater transparency. With regard to food and fertiliser subsidies, the budget displays numbers which had hitherto been masked. As against a budget estimate of ₹1.15 trillion (S$23.31 billion) for food subsidy, the revised estimate is a whopping ₹4.22 trillion (S$83.9 billion). For fertiliser subsidy, the corresponding figures are ₹71,309 crore (S$4.79 billion) and ₹1.34 trillion (S$26.64 billion). On the other hand, the estimation of the fiscal deficit is conservative viz on the higher side. Analysts believe that the estimation of fiscal deficit in fiscal year (FY) 2021-22 at 9.5 per cent, projected to decline to 6.8 per cent in FY2022-23, could be lower, as sizeable cut backs in expenditure is on the cards. Tax revenue assumptions also appear to be on the modest side.

The other feature of the exercise is that it breaks out of the pandemic psychosis. It proposes bold measures to boost growth by spending on infrastructure creation. Increased capital expenditure in infrastructure has a multiplier effect on various other sectors, thereby creating jobs and enhancing incomes. The discernible drive is towards ensuring funds for construction activity by espousing reforms in the financial sector. The first is the creation of a development finance institution with an equity contribution of ₹20,000 crore (S$4 billion). Considering that banks have still not come out of the woods and in any case do not provide long tenor funds, such an institution will certainly catalyse funding to the infrastructure sector. This will relieve the banks from funding these projects as they risk asset-liability mismatches in providing such long duration loans. This has been a much-needed source of funds. Substantial funds have been provided for road building in the four poll-bound states of West Bengal, Kerala, Assam and Tamil Nadu, attracting the criticism that it is politically motivated. No doubt that the choice of the states has political considerations, but at least, roads will be built.

The government also seems to have bitten the bullet on the setting up of a 'bad bank' viz an asset management/reconstruction agency. Debate around the advisability of a 'bad bank' has been raging for five years now. Whilst its pros and cons were hotly debated in every economic forum, no decision had emerged till now. 'Bad banks' have professionals engaged in managing stressed assets reconstruction. They handle such assets far more effectively than commercial bankers who continue to carry these assets on their books, thereby restricting their capacity to enhance credit growth. However, care will have to be taken to ensure that the professionals selected are appropriately skilled. It would be major fallacy to shift personnel from commercial banks to staff the 'bad bank'.

Divestment of public sector banks and other enterprises has also been on the cards. Despite announcing the privatisation of IDBI Bank in the 2015 budget, no progress could be made. This time, the government has announced an ambitious proposal to privatise two public sector banks, divest stake in one non-life insurance company and conclusively decide on the divestment of Air India. This will generate the much-needed funds, thereby lessening the burden on government resources. It will also obviate the need to inject equity capital into these enterprises on an annual basis. Another proposal, which has been deliberated at length earlier but shelved, is increasing foreign holding in private insurance companies from 49 per cent to 74 per cent.

Much has been said about inadequate provision in the budget to boost the health of micro, small and medium enterprises. It needs to be recognised that provisions in this budget have been premised on the releases already made in the stimulus packages announced earlier. On the other hand, to boost manufacturing activity, provision has been made for performance-linked incentive schemes for manufacturing to create global champions. The budget also addresses the urgent need to upgrade the health infrastructure specifically designed to meet the COVID-19 vaccination requirements. Defence has also received a hike of 19 per cent in its capital outlay for modernisation.

The government has reposed trust in economic growth leading to tax buoyancy and hence resisted the temptation to raise taxes. Complementing this is the reform agenda of privatisation. The government needs to display huge political will and sincerity of purpose to be able to meet its divestment agenda. The budget has been widely welcomed and it is hoped that the government will deliver on its promises.

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