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India's New Budget: Changing Course without Controversy

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Very few Indian budgets in recent years have been presented in a more favourable backdrop than the budget presented by Finance Minister Arun Jaitley on 28 February 2015. The Economic Survey, presented a day before the budget, portrayed the Indian economy as having hit a 'sweet spot' and forecasted an economic growth of more than 8% in the next financial year. It also emphasised that the country was set for 'big bang' reforms.

The Finance Minister would have been aware of the tremendous expectations from the Modi government's first full budget. Unlike the budget presented last July, which was clearly hastily drafted and a 'please all' effort, the current budget had its stage set. Inflation was under control thanks to the unprecedented fall in global oil and commodity prices. The stock market was robust with the foreign institutional investors (FIIs) having made a forceful comeback. The external sector and balance of payments conditions had improved remarkably. Better fundamentals were also

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showing signs of committing a cautious Reserve Bank of India into an easier monetary policy.

The most onerous challenge for the Finance Minister was managing the public finances. The budgeted fiscal deficit target of 4.1% of GDP (Gross Domestic Product) was looking difficult to be met, given the overestimation of revenues. Matters could have worsened following the 14th Finance Commission's decision to substantially increase the share of states from the tax proceeds collected by the Centre. But the new GDP figures released by the Central Statistical Organisation (CSO) a few weeks before the budget came to the Finance Minister's rescue.

Indeed, had the new GDP figures not given the cushion of a higher base, the Finance Minister would have found it almost impossible to meet the budgeted fiscal deficit. Buoyed by a projected GDP growth of 7.4% for the current fiscal (2014-15), almost two percentage points higher than what most were expecting before the new numbers came, the GDP growth estimation for the next fiscal could also be more optimistic. The baseline GDP growth for the budgeted estimates has been around 8% or more, a luxury that was impossible to visualise a few weeks ago.

The new budget is similar to the previous one in that it has tried to be politically correct and satisfy as many constituencies as possible. But unlike its predecessor, it has done a better job of doing so. And it has done so without going 'big bang'.

The budget has something for practically everybody. As a starter, it has pleased analysts and experts who were demanding higher public investment in infrastructure for accelerating and multiplying the growth momentum in the economy. Following the pattern of capital finance outlined in the Rail Budget, public outlays have been sharply increased on roads and railways. Tax-free infrastructure bonds for rail, road and irrigation projects are expected to channelize considerable household and corporate savings into infrastructure financing. These would be matched by the funds allocated to the newly-created National Investment and Infrastructure Fund (NIIF).

The world was expecting the Finance Minister to announce a date for rolling out the Goods and Services Tax (GST). As of now, it is April 2016. While the Finance

Minister has not specified whether the date is cast in stone, ample references to the GST as a 'game changer' in the budget raise hopes of it being more sacrosanct than other tentative datelines announced in previous budgets.

While not going 'big bang', the budget has its fair share of innovative structural measures. Economists and experts have demanded many of these for long. The more significant ones include merging the Forward Markets Commission – the regulator for commodity futures – with the Securities and Exchange Board of India (SEBI); proposing a law for streamlining the process of public procurement; introducing sovereign gold bonds and facilities for gold depositors to earn interests in metal accounts; creating a Public Debt Management Agency for managing both external and internal borrowings; and encouraging public ports to corporatize under the Companies Act for attracting greater private investments. In what could be a significant structural measure for channelizing Indian investments into manufacturing activities in Southeast Asia, a project development company has been proposed for facilitating investments in Cambodia, Lao, Myanmar and Vietnam.

Foreign investors would also be happy to note the decision to do away with the distinctions in various types of foreign investments, particularly portfolio and direct investment, and to replace them with composite sectoral caps. In addition, what would clearly be a greater relief for them is the decision to defer the General Anti-Avoidance Rules (GAAR) on corporate taxation for at least two years and the Finance Minister's commitment to apply these rules, whenever they come in, prospectively, and not with retrospective effect as the previous United Progressive Alliance (UPA) Government had indicated of the doing.

Several investors looking at India have been concerned over the delays experienced in getting projects off the ground. Many of the projects that are stuck are in the public private partnership (PPP) mode. Banks that have extended credit to private investors for investing in these projects are worried over recovering their loans. The new budget emphasises review of the PPP mode of infrastructure development and admits the importance of government bearing greater risks in these ventures. Investors would have been looking for greater clarity in this regard, particularly in terms of the risk-

sharing structures that the government is contemplating. However, the Budget has stopped short of being specific.

Many critics of the Modi Government have accused it of being anti-farmer. The accusation has been particularly sharp in the context of the amendments that the government proposes to introduce to the land acquisition, resettlement and rehabilitation legislation passed by the earlier UPA Government. These criticisms have been attempted to be addressed by special programmes announced for irrigation and watershed development and a ramp-up in agricultural credit. Indeed, by announcing the largest step-up in allocation to the MGNREGA and the universal social security and pension schemes, the budget has scored a political point by declaring commitments to empowering the poor.

Industry and business could hardly complain over what the budget has delivered for them. The phased lowering of corporate income tax from 30% to 25% was a bit unexpected at a time when the Centre would have to give up more revenue following the recommendations of the Finance Commission. Prospective investors for 'Make in India' would also be happy over the various fiscal incentives offered for the scheme including the tax 'pass through', higher investment and depreciation allowances and reduction of customs duty on various essential raw materials, intermediates and components.

Tax proposals in the current budget have been unusually long and detailed. These have tried to reach out to as many sections as possible across corporates and households. A lot of thought has gone into these proposals, which is evident from the fact that while not increasing the standard deduction limit for exemption from income-tax for households, the scope for exemptions has been increased through health and pension contributions in the social security schemes to be floated.

The budget has fussed over the Government's intention to introduce a law for curbing growth of black money. Some of the features of this proposed law point to the strict penalties that are likely to come with respect to non-disclosure. While curbing black money is a laudable objective, one hopes the proposed legislation does not revive the ghosts of the draconian Foreign Exchange Regulation Act (FERA) of the 1970s. An

exceptionally prohibitive Act might become a productive rent-seeking weapon for the regulatory agencies, as the incentives for avoiding high penalties would be equally high.

The budget has not cut subsidies. This would be disappointing for some, given that the current economic backdrop would have been ideal for doing so. It would have also been rational since the government needs to create more fiscal room. It is also perplexing that the budget makes no mention of disinvesting government equity in public enterprises – an effort that was conspicuous in the earlier budget. The long-term reform agenda is virtually left untouched, given no mention of labour or insurance reforms.

Evidently the intention behind the budget was to act decisively on the economic parameters while not ruffling political feathers. The Finance Minister has been reasonably successful in doing so. Those urging the Big Bang would have to wait for even sweeter spots and riper occasions.

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