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Modi Government's First Indian Budget

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As days pass, India's Finance Minister Arun Jaitley is seen to be increasingly defensive about the Narendra Modi Government's first Budget. Commentators have spoken about continuity of the previous United Progressive Alliance (UPA) Government's thinking, lack of big-bang reforms agenda, a plethora of schemes that do not appear to be fully funded, and the lack of a clear articulation of vision. Corporate leaders complain that the spectre of retrospective taxation has not been lifted. There is no clear focus for manufacturing or for tackling inflation, two of the more important worries of the Indian economy.

Perhaps these are criticisms from sections that feel that their grievances have not been addressed. It is necessary to look at the budget from the point of view of the reforms agenda that has been unveiled, and the follow-through that is promised. The target was to boost growth, correct the fiscal deficit and to fix inflation. To a substantial extent, the budget attempts to address these concerns.

Two important points are to be noted. The first is that, unlike the initial UPA budgets, there has been no attempt at mudslinging at the previous government for the poor state of public

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finances. Second, there has been no attempt to throw out UPA programmes, especially the welfare programmes — these have been retained, and well-funded. It is not surprising that the UPA members are commenting that it is a budget of continuity rather than change. Actually, the budget makes significant departures from the earlier philosophy, and it is important to identify the strategy behind these changes.

First, the budgetary numbers are constrained by the overhang of substantial unpaid bills, especially for food- fertiliser- and energy-subsidies. Even if there is a promise to reduce the subsidy burden, past bills need to be paid. The budget is relying on substantial receipts from divestment to meet these obligations, without hardening the tax rates.

Disinvestment and the Market

Healthy disinvestment receipts require an active and buoyant equity- and bond-market, and there are significant announcements for the financial markets and for Foreign Direct Investment – 49% in insurance and defence sectors is being offered, besides increased incentives for investment in real estate and insurance. There is a budget provision for recapitalisation of banks, and a promise to allow retail sale of bank equity to help capitalisation. Infrastructure bonds issued by banks have been exempted from SLR and CRR norms, which might result in a big boost to the availability of funds for infrastructure projects.

The measures unveiled for the commodity- as well as equity- and bond-markets are intended to keep these markets buoyant for some more time, helping receipts from divestment. These would also help revive equity offerings and new equity placements by existing as well as new entities. In particular, infrastructure companies short of funds for implementation would have greater avenues to access capital.

This budget lasts only until next February, and it is important to clean up the books in terms of liabilities and debt overhang, so that the next budget can look at funding projects that have been announced in this budget. In any case, several of the announcements have to be converted into feasibility studies and projects, before funds-flow in any significant quantities is drawn down; and the steps taken in this budget allow government the breathing room to do this. There appears to be a clear strategy of preparing for a big implementation programme next year, based on the announcements made.

There are also announcements that encourage savings, including additional deductions for investment in specified funds, greater flexibility for the savings schemes and certificates of the government. This budget attempts to bring the retail investor back directly into the equity- as well as the savings-market — an attempt not only to garner additional funds for the government but also to reduce consumption liquidity and to take some pressure off consumption demand. If successful, this would dampen inflationary pressures as liquidity is parked in savings rather than spent on consumption. Simultaneously, there would be greater investment capital in the hands of banks and corporate sector, especially in infrastructure; and that would help revive growth.

Market-Facilitator Role

Second, there is a clear direction of policy articulated in the Economic Survey. The government sees itself as a market-facilitator, and sees its role as that of correcting distortions in market mechanisms. Capital creation and efficient allocation of capital for growth and development would be the responsibility of markets. Greater emphasis is placed on public-private partnerships, and there is recognition that PPP models have met with mixed success. There is a clear distancing from the entitlements-based approach of the UPA. While the livelihood support programmes like the MNREGA have been retained, they are being oriented towards asset creation and improvements in agricultural productivity rather than mere wage-based daily activities. The change of direction towards a more market-oriented economy is clear.

The initiatives announced take this thought further. There are concessions for real estate and for the power sector, as well as a host of incentives for the small- and medium-enterprises. Already, prior to the budget, the infrastructure ministries including power and coal as well as surface transport were working hard to resolve a number of bottlenecks that are holding up projects under implementation. The budget would now help these towards speeding up completion.

FDI in Defence Sector

Third, there is encouragement for FDI. The move for FDI in defence is interesting. Given 49% and no control, it is unlikely that large armaments manufacturers or technology

providers would appear enthusiastic. Perhaps this should be seen more as an attempt to improve manufacture. There are large armed forces as well as paramilitary organisations and the state police, who all require substantial support-equipment — uniforms, bullet-proof vests, night-vision glasses, travel accessories, mine-detectors and electronics etc. This constitutes a huge market, and it is even accessible to the SMEs. Perhaps there is an opportunity to leverage this announcement to invigorate the manufacturing sector. The insurance sector is being revived, with a promise of FDI in that sector.

Fourth, there is a genuine thrust in the budget towards social services. Tertiary institutions in engineering and medicine are being set up in many states (i.e. provinces). There is also focus on tourism, on preservation of heritage. A number of schemes for women and children have been announced. Existing programmes like MNREGA would continue, with some focus on asset creation. Fifth, there is attention to SMEs. A number of initiatives, including greater access to credit and technology, have been unveiled.

The Budget Arithmetic

Now, the budget numbers: the Finance Minister has retained the fiscal deficit target of 4.1%, and revenue receipts look as aggressive as they were when his predecessor presented them a few months ago. The target for Plan expenditure on capital-accounts continues to be modest. All programmes of the past are continuing, and revenue improvements are anticipated through solving litigation rather than extending coverage. The concessions in customs duty follow the traditional cherry-picking model, with no explanation of why these have been chosen and not others. An incentive for manufacturing could have come through reduction in excise duties, but this has not happened. The taxation part of the budget appears no different from any in the last two decades, and this is a disappointment and a lost opportunity. Tax slabs have been retained, with some relief in initial exemption limits. It is clear that the Finance Minister, in Part Two of the Budget Speech, has been guided by continuity rather than the need for change.

Capital expenditure under the Plan, at Rs 121,497 crores (a uniquely Indian arithmetical unit of account) is only a little above the revised estimates of last year, and not enough to meet the expectations in regard to all the programmes announced. The borrowings figure, at Rs

531,177 crores, is still quite large, and higher than last year's in absolute terms. This would continue to be a drag on the economy.

Analysts expected some more. In agriculture, while there is recognition that food prices are a major inflationary factor, there is little that has been said on inflation control. The fiscal deficit figures are also not quite reliable, since the borrowings up to end-June this year are already way beyond budgetary limits. Credibility of the figures is in question, as there is no fresh taxation, nor are there any measures to curb expenditure. The expert group on expenditure that has been constituted would have little effect on the figures of the current year. Ratings agencies are quite unhappy with the lack of direction here, and there are comments that this has been hastily put together.

There was an alternative, though unusual, available to the Finance Minister. If he had felt constrained by lack of time and analysis, he could have rolled over the budget to the supplementary estimates in September. In other words, he could have continued with the previous Finance Minister Chidambaram's budget numbers with a vote-on-account and come up with a substantive budget for half-a-year in September that could set the tone for the next year.

There is room to expect clearer articulation next time round, in February 2015. It is also important to note that as the economy grows, the Central Government budget accounts for an increasingly smaller percentage of the total economy — less than eight percentage of GDP this time compared to around 12% of GDP ten years ago. Clearly, the scope of public finances leveraging the economy is diminishing as the economy grows.

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