India’s Budget Covers Yesterday and Tomorrow — But Not Today

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Finance

At the customary post-Budget press conference address by Indian Finance Minister Arun Jaitley, he was asked why his Budget lacked a single big-bang idea. Jaitley was prepared for such a question. “Many people have told me that you must have a big-bang idea, and I have asked them to suggest one,” he countered. “Give me one big idea that isn’t there.” His questioner was unprepared; no suggestions were offered.

Without any big ideas, the Budget should have gone down as pedestrian. But it had one thing going for it: The economic environment in the country has improved so remarkably that even an uninspired Budget can do little damage. The Economic Survey — a report card for the government, tabled in Parliament the day before the Budget was announced — spoke of the *achhe din* (“good times,” a Prime Minister Narendra Modi slogan). “India has reached a sweet spot — rare in the history of nations — in which it could finally be launched on a double-digit, medium-term growth trajectory,” read the survey.

Jaitley himself started his speech talking about the achievements of the past few months. “I present this Budget in an economic environment which is far more positive than in the recent past,” he said. “When other economies are facing serious challenges, India is about to take off on a faster growth trajectory once again. The International Monetary Fund has downgraded its earlier forecast of global economic growth by 0.3%, and the World Trade Organization has revised its forecast of world trade growth from 5.3% to 4%. Forecasts for India, however, have either been upgraded or remained the same…. Real GDP growth (this year) is expected to accelerate to 7.4%, making India the fastest-growing large economy in the world…. The world is predicting that it is India’s chance to fly.”

All that didn’t inspire Jaitley to take any radical initiatives. Read the headline of an article in the *Economic Times,* which interviewed former Prime Minister Manmohan Singh on the Budget: “Lucky, not plucky.” Says Ravi Aron, professor at Johns Hopkins Carey Business School: “This Budget is a significant improvement in many aspects but it is not a ‘big leap forward reform Budget’ of the kind presented by [then Prime Minister] P.V. Narasimha and Manmohan Singh [then finance minister] in 1991.”

Jaitley noted that his government had introduced the Jan Dhan Yojana (a program for financial inclusion), undertaken coal auctions (earlier mired in corruption and court cases) and launched the Swachh Bharat (Clean India) program. “They have been successful so far in these initiatives,” says J.N. Mukhopadhyaya, director of the J.D. Birla Institute department of management. “But all this started months ago. What does it have to do with this Budget? It’s all yesterday’s Budget.”

> *“It’s all yesterday’s Budget [and] tomorrow’s Budget. Where is today’s Budget?”–J.N. Mukhopadhyaya*

“We are now embarked on two more game-changing reforms — GST (Goods and Services Tax) and what the Economic Survey has called the JAM Trinity — Jan Dhan, Aadhaar (a unique identification number) and Mobile — to implement direct transfer of benefits [to the underprivileged],” said Jaitley. “GST will put in place a state-of-the-art indirect tax system by April 1, 2016. The JAM Trinity will allow us to transfer benefits in a leakage-proof, well-targeted and cashless manner.” According to D. Shivakumar, chairman and CEO of PepsiCo India: “GST will change the way India manufactures, supplies and distributes goods and services.”

“All that is tomorrow’s Budget,” says Mukhopadhyaya. “Where is today’s Budget?”

Investors in the stock market also seemed to feel that there wasn’t really a Budget they could pass judgment on. The day before the Budget announcement, the Bombay Stock Exchange Sensitive Index (Sensex) rose 473 points or 1.65%, to close at 29,200. On Budget day, from a pre-Budget high of 29,492, it fell at one stage to 28,890, to finally end the day at a higher 29,361 (a gain of 141 points or 0.48%). “It took some time for the market to understand that there were many positives,” says Bundeep Singh Rangar, chairman of London-based consulting firm IndusView.

The next trading day — March 2 — the Sensex climbed, then fell and kept up its gyrations throughout the day. The factor that was doing most of the damage to the index was cigarette manufacturer ITC; Jaitley has increased excise on cigarettes between 15% and 25%. ITC is an isolated case; both Deutsche Bank and Citigroup have set the December 2015 Sensex target at 33,000, a 10%-plus increase over present levels. The markets don’t need a big bang.

Incremental Steps

But anyone who had read the Economic Survey would not be holding his or her breath for a big bang. The Survey had argued that “creative incrementalism could cumulate to Big Bang reform.” The government has issued several ordinances — the most controversial being one on land reform — that have to be cleared by Parliament. Adding a big bang to the Budget would have created another hot potato.

“,” says Saikat Chaudhuri, Wharton adjunct professor of management and executive director of the Mack Institute for Innovation Management. “Just look at his track record. Modi’s development strategy in Gujarat [where he served as chief minister] had three elements. First, creating infrastructure and land banks for several years before aggressively courting investors and publicizing his industrialization achievements. Second, providing administrative efficiency. Third, enacting policy changes over time.
“Given his success and experience with that model, he is probably going to adopt a similar approach at the national level as well to the extent possible,” Chaudhuri continues. “The challenge is two-fold: Conditions in other parts of India are not the same as in Gujarat. It has, for instance, an innately entrepreneurial and risk-taking culture as well as swathes of fairly arid land. More importantly, Modi’s development model essentially requires two terms, one for building the foundation and the second for ramping up growth. But ensuring a re-election at the national level is much more difficult than at the state level. This is especially hard, given his penchant for avoiding populist measures.”

Looking at the Long Term

If you accept the absence of a big bang, things start falling in place. “This Budget is the first chapter of a series of measures over the next few years,” says Shivakumar. Adds Rajesh Chakrabarti, executive director of the Bharti Institute of Public Policy, Indian School of Business: “It looks like a step in a longer journey, which is exactly what Budgets should be, rather than an attempt to solve most problems in a single stroke. That is a fundamental shift from the practice of having Budgets as independent events. This is particularly important with the discontinuation of the Planning Commission.” (The Modi government has replaced it with a new body — the NITI Aayog.)

> *“Everyone seems to have been anticipating big-bang reforms, but I’m not at all surprised that the government did not offer them.”–Saikat Chaudhuri*

“This a serious attempt to get supply-side economics right to boost long-term growth, especially productivity growth, including infrastructure, R&D and education; a tax structure that encourages start-ups and social sector programs that create employment, as well as increase demand for products and services,” says S. Raghunath, professor of corporate strategy and policy at the Indian Institute of Management Bangalore (IIMB).

Positive Strokes

“The Budget has been revolutionary in two ways,” says Vivek Kulkarni, founder of the Brickwork Group and former Karnataka IT secretary. “First, the government accepted the Finance Commission’s recommendations and decided to devolve over 62% of its resources to the states. It has abolished the Russian-era Planning Commission that doled out grants to states in a discretionary way. Thus, the new government has introduced fiscal federalism, unlike the previous one which centralized most powers. Second, the recent government coal auctions resulted in billions of dollars of revenue. Such mines were allocated to their favorites by the previous governments at throwaway prices. The transparent auction was a welcome departure. The government has promised the same in other minerals, power and infrastructure bidding, which is a good sign.”

According to Manish Sabharwal, cofounder and chairman of TeamLease Services, India’s leading staffing company: “After a decade of Budgets that prayed to the God of subsidies, it’s wonderful to have a Budget that prays to the God of job creation.” Pointing out that many politicians since Independence believed that “strong states lead to a weak nation,” Sabharwal says: “This Budget and the Economic Survey reinforce the narrative since the last election that the central government will devolve money and power to state governments. This is great for job creation. This Budget also announces the most impactful overhaul of labor laws since Independence — a revamp of our employee pension and health insurance regimes. The government monopolies — the Employees’ Provident Fund Organization and Employees’ State Insurance Corporation — have been inefficient, arrogant and offer poor value for money. Giving employee salary choice while retaining the status quo will substantially increase formal employment and have huge cascading effects on productivity.”

Among the more notable features of this Budget is the reduction in corporate tax from 30% to 25%. It boosted the markets but is only going to be applicable in 2016-2017 and is spread over four years. “The proposed reduction in corporate tax from 30% to 25% over four years helps counter the notion that India is a high-tax nation,” says Shivakumar. “This concept of making India attractive to investors will be an ongoing roadmap, and the country must take one extra step with every Budget.” Chaudhuri doesn’t see real change on the ground. “The phased corporate tax reduction is largely symbolic, as it will be accompanied by a removal of various deductions and exemptions,” he says. “But simplification may bring its own benefits, too.”

The Budget has several measures on health care, jobs, skilling and education. “The Budget emphasizes providing the basics for everyone, which is absolutely necessary for inclusive development and a minimum standard of living,” says Chaudhuri. Adds Shivakumar: “The finance minister has announced significant investments in education, health, housing, women, and child development and rural development. A lot of these investments benefit the disadvantaged portions of society, and that’s something all of society owes them.”

Outlay for Infrastructure

The other measures to take note of, according to Chaudhuri, are: the large outlay for infrastructure ("consistent with the build-a-foundation-first type of approach"); the move towards securitizing gold ("it unlocks a huge source of potential funds"); the mention of entrepreneurial ecosystems and innovation ("I feel this is a baby step in the direction where India could go in being an innovation leader"); and the substantial target for privatizing public sector units.

"We believe the government's 2015-2016 fiscal deficit target hinges on its disinvestment target of $6.4 billion," says a report by ICICI Securities, an e-brokerage. Privatization in India has always been a problem. Left parties have likened it to "selling the family silver." In previous years, the shortfall has ranged between 20% and 65%. In 2014-2015, Coal India's $3.7 billion issue was pushed through with the domestic financial institutions taking up large stakes. The other big issue — a $3 billion follow-up offer (FPO) from Oil & Natural Gas — may not be as lucky. The company's share price has dropped because of declining global oil prices. A back-of-the-envelope calculation shows that the FPO makes sense only if crude rises to $70 a barrel. At the end of February, Brent crude was trading at less than $50 a barrel.

Aron agrees that divestment is "going to become very important" for this government. "The government's projection of its deficit is based on revenues generated by an 8% or more GDP growth. This is not a trivial challenge. If GDP growth falls below 8%, the revenue deficit will balloon." Pointing out that there is a lot of money "left on the table" for the government to mop up via disinvestment, Aron notes: "There are several public sector undertakings ranging from coal to fertilizers and the perennial black hole of capital — Air India — that need to be privatized. The government can mop up significant capital without adding to the deficit by divesting in these enterprises." He adds: "There is another case, too, to make for divestment. From 2015-2016 onwards, about 62% of the total tax revenues collected [by the center and the states] will go to the states as opposed to about 55% now. With the increasing share of the states in the revenue collected, the government will need to both find alternative sources of capital as well contain its costs. There has never been a better time to divest.

> *"It looks like a step in a longer journey, which is exactly what Budgets should be, rather than an attempt to solve most problems in a single stroke."–Rajesh Chakrabarti*

"The second benefit of divestment has to do with containing the government's variable expense," Aron continues. "Government spending on public enterprises in the case of loss-making entities can be greatly mitigated by transferring those entities of the public's P&L into private ownership. The public exchequer should not pay to subsidize a labor aristocracy that dips into the taxpayer's pocket as an entitlement. Even in the case of profit-making enterprises, the government is better off transferring the low-performing (low returns on invested capital) PSUs into corporations."

Attracting Foreign Investment

What is in this Budget for the foreign investor? "The Budget is very positive for foreign companies and investors," says Ankur Bisen, senior vice-president, retail, at Technopak, a Delhi-based consultancy. "There is a clear thrust to develop the Indian bond market to international standards. Also, the Budget is focused on shoring up investments in roads, ports, shipbuilding, power and railways. These two points will make many foreign investors take note of India. Foreign companies that have interest in these areas will see positives in the next two-three years."

"Of note is the removal of the distinction between portfolio and direct foreign investors; this could pave the way for strategic investments by foreign entities in Indian firms and speed up growth," says Chaudhuri.

"The deferral of GAAR (the General Anti-Avoidance Rule) for two years is helpful for foreign investors, as are as the changes in tax rules pertaining to transfer pricing," says Raghunath. These were contentious issues and had put off many foreign investors. More importantly, Jaitley made it clear in his speech that "GAAR would apply prospectively to investments made on or after April 1, 2017″. The word "prospectively" — which is reflective of the government's thinking in other areas, too — has brought much cheer to foreign investors. Some of them, like

Vodafone, have suffered from the previous government's moves to change laws with retrospective effect.

Equally important are moves to improve the ease of doing business. Redtape and the number of permissions needed are being cut. "This will make it easier for MNCs to enter India," says Raghunath. "It will help attract more FDI." Chakrabarti points out that, as always, it depends on implementation.

Chaudhuri feels that more could have been done. "Three important items are missing from the Budget," he says. "There is no overarching vision of what India aspires to become. This would provide a signpost as to how the individual pieces fit in and, more importantly, would allow Modi's government to galvanize popular support in implementation. Second, there are also no comprehensive timelines and associated milestones, which I would have expected from a government that prided itself on administrative efficiency and transparency at the state [Gujarat] level. Third, many of these items are somewhat longer term and abstract, and there needs to be some concrete 'quick win' achievements visible which can be capitalized upon as catalysts for positive momentum and large-scale support."

Far more critical is M.V. Rajeev Gowda, professor of economics and social sciences at IIMB. "Where are the ideas? Where is the reformist agenda this government promised?" he asks. "The JAM served by the Budget is nothing more than a product of the previous [Manmohan Singh] government. The Budget is a name changer instead of a game changer." (Gowda is a member of the Rajya Sabha from Manmohan Singh's party.)

"This is a pragmatic Budget that does not play to the gallery," says Shivakumar. "A Budget in today's India will never be unanimously appreciated or unanimously derided. India needs to create a million jobs every month, contain inflation, reduce fiscal deficit below 4.1% and be attractive to investors by easing the rules and also being consistent with policy. No Budget can score high on all the outcomes that every stakeholder expects. The challenge for the finance minister is real, and there is no silver bullet."