Expected joys with some disappointments

This budget will certainly give the Indian economy a push upward, although the effects of some of the proposals may be felt later, writes S.L. Rao

Commenting on Arun Jaitley's first budget speech last year, I said, "It was boring. It presented no overarching vision of how the economy would shape over five years and the economic policies of the new government." This year he was different. The professional managerial railway budget by Suresh Prabhu presented the vision of 'customer first' and a five-year programme of safety, hygiene, comfort, speed, timeliness and an investment plan with possible sources of funding. Jaitley has followed suit.

This budget was expected to define the reform and growth credentials for this government. The context, even with doubts about the revised gross domestic product estimates, was that India was in a strong macroeconomic position, with the consumer price index inflation down to 5 per cent, improved balance of payments, record foreign exchange reserves, declining crude oil prices and a strengthening rupee. The problems were those of weak agriculture growth, manufacturing at only 17 per cent of GDP against over 30 per cent in many developing economies, poor nationalized bank finances, an urgent need to move over half the population from agriculture to other occupations, the need to develop roads, railways, ports, airports and urban and rural housing. India had to say it was moving from over 60 years of State-controlled economy to one where the private sector would be growing in importance. Policies and actions had to be perceptibly welcoming to private foreign and domestic investment, implement more efficient public investment and better governance and management of State-owned banks and enterprises; they had to improve ease of doing business, tighten independent regulation of all productive sectors, control black money, introduce measures for monitoring outcomes for all government expenditures, extend support to agriculture in finance and marketing, rationalize subsidies and welfare programmes to make them effective and less wasteful, and ensure more devolution of Central funds to state governments.

Jaitley has delivered in full on some, on others partially or initially, and on a few, not at all. He is achieving the year's fiscal deficit target of 4.1 per cent, helped by the unexpected higher growth now announced for 2014 at 7.4 per cent. He has extended the three-year time frame by a year to get to 3 per cent, but has benefited by the somewhat dodgy revision to GDP growth in 2014 to 7.4 per cent. The rail budget and the proposals to spend on roads, power, ports, rural and urban housing, sanitation, safe water supply, and other infrastructure, and agriculture, plus defence ("Make in India"), will give a boost to the economy and to the private sector. Tax-free bonds, long term infrastructure development bonds and a special fund, partial sovereign guarantee to public private partnerships in infrastructure, and plug and play projects (presumably assuring all clearances in advance) like the five new ultra mega power projects, with similar ones in other infrastructure, will boost investment. Cement, steel, aluminum and other basic materials will all benefit. The proposal to make regulatory laws more uniform is long overdue but does not address the problem of weak regulators appointed almost solely from retiring government employees.

Proposals to encourage innovation, start-ups, research expenditures, and help tiny, small and medium enterprises with capital are all to the good. They are often a repeat of past proposals; the implementation has been weak and may continue to be so since no institutional methods are clearly stated.

The target of reducing marginal corporate tax rates over four years while reducing exemptions and incentives, abolishing wealth tax and introducing a surcharge on income tax in its place will reduce disputes and litigation and add to revenues. It does add to the ease of doing business in India. But Minimum Alternate Tax rates have not been reduced, a key demand from industry. Tax administration is also to improve further with greater computerization. No addition is proposed to the Direct Tax Code. General Anti-Avoidance Rules or GAAR is postponed by two years. It would have been better to abandon it since it will be a looming Damocles sword. The Goods and Services Tax is to be effective from April 1, 2016, a very welcome development for ease of business. Instead of categorically giving it up, there is again a mention as last time that retrospective taxation will not be used. The proposal to make the bankruptcy laws in India more akin to developed countries is welcome since it will help business closures when necessary.

However, the proposals to control black money held within and without India seem to be more about stringent penalties but there is nothing to prevent its generation. Penalties, while necessary, are, as we have repeatedly seen in India, subject to abuse. The proposals do not include public funding for elections, introducing severe penalties on candidates who overspend, encouraging state governments to reduce property taxes, eliminating differential capital gains taxes given to investments from some countries, anonymous overseas investments and so on. Proposals to have gold held by individuals in interest bearing bonds are interesting but may not tempt those who hold black money as gold.

Amendments proposed to the Foreign Exchange Management Act and to the treatment of foreign portfolio and direct investments will certainly promote foreign investment. Amendments are proposed to laws so that multiple prior approvals for new investments are avoided. But there is no mention of reducing the burden of reporting required by various levels of governments, from all industries.

The Narendra Modi government was expected to follow the advice wrongly attributed to Jagdish Bhagwati that growth must get precedence over social welfare expenditures. Instead, the proposal is to increase the expenditures on the rural employment guarantee scheme and add a slew of schemes for the higher education of poor young people and support to senior citizens, for a universal pension scheme, health and life insurances at low rates, for support to women, higher education in schools within five kilometres from any village, for setting up more institutes for advanced work in medicine technology and management in some more states, for a social safety net and so on. There is, however, no mention of quality improvements in social services, especially education, and of the severe shortages of faculty in all fields. The budgets for health and education need examination. The introduction of Direct Benefits Transfer has come closer with the opening of 10.3 crore bank accounts and using the over 1.5 lakhs post offices as banks, especially in rural areas.

Two other proposals must be commended. The proposal to consult state governments to amend the Agricultural Produce Marketing Act that acts as a constraint on farmers getting better prices is one. The most significant of the budget proposals emanates from accepting the 14th Financial Commission report that is in line with Modi's "cooperative federalism", giving greater autonomy to states in receiving funds and spending them. The state governments will now receive 42 per cent of the divisible pool of Central taxes (Rs 5.24 lakh crore to states in 2015-16 *versus* Rs 3.38 lakh crore in 2014-15), in addition to Rs 3.04 crore as Central grants, adding to 62 per cent of Central receipts.

The budget speech mentions disinvestment but not privatization, showing the lack of understanding of the damage to the economy caused by poor governance and management of State-owned enterprises leading to inefficiencies.

This budget will almost certainly give the economy a push upward. The numbers, in many cases, are small, as in the last Jaitley budget, and their effect may not be seen until the amounts are large enough. Jaitley could have tapped on provident, gratuity and insurance funds to finance private-public partnerships, especially in infrastructure, in addition to foreign investment. The overall addition to tax revenues from this budget is about 1 per cent of the total, a flea bite for the ambitions of this government. Modi has yet to demonstrate by action that he wants to implement the total change of direction to the economy that was hoped from him.

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