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Restoring inclusive and sustainable growth in India

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INDIA'S annual federal budget, presented on Feb 1, was watched with interest – not just as a fiscal instrument for steering Asia's third largest economy but also for economic reforms measures amid a slowdown in economic growth.

The budget addresses twin objectives: It reinforces the ongoing process of economic transformation and inclusive development launched in 2014. It also seeks to revive economic growth in a manner that is fiscally sustainable and addresses the underlying causes. The Reserve Bank of India's monetary policies are also supportive of growth, while keeping an eye on inflation.

The context bears mentioning. Over the five years to 2019, India's economic growth averaged 7.4 per cent a year. Inflation, fiscal deficit and external current account deficit declined. Foreign direct investment (FDI) reached record levels of US$284 billion.

There has been unprecedented progress on empowerment and inclusion that has given tens to hundreds of millions access to bank accounts, insurance, pension, micro-credit, homes, sanitation, electricity and affordable health care. Major reforms for the industry have been accompanied by the evolution of the world's largest public digital infrastructure. These are transforming the economy and changing lives in myriad ways.

Prime Minister Narendra Modi led the government's return to office with a larger mandate in May 2019. Since then, policy attention has turned to reviving economic growth. This budget builds on measures announced over the year to boost consumer demand, lift investment, expand infrastructure, ease credit and restore the health of the financial sector, as we aim for a US$5 trillion economy in the next few years.

Government capital spending will grow 21 per cent this year, mostly on expanding infrastructure. Beyond that, the government is investing US$3 billion in two infrastructure vehicles to generate additional US$15 billion for infrastructure.

Consumer spending will benefit from reduction in personal income tax rates, cheaper loans, a special stress fund to revive stalled housing projects and extension in tax benefits to buyers and developers of affordable homes.

Corporate tax rates have been slashed to 22 per cent, and to 15 per cent for new domestic companies. The Dividend Distribution Tax has been removed. The Goods and Services Tax has been rationalised and reduced, resulting in a 10 per cent reduction in overall tax incidence. “Make in India” will benefit from the rationalisation of customs duties that addresses the tariff inversion problem and an open FDI regime. The Insolvency and Bankruptcy Code is contributing to the recovery of loans, unlocking productive assets back into the economy and improving corporate environment.

The budget emphasised wealth creation as a fundamental objective, but not just from the big corporates and cities. It seeks to generate enterprise and innovation in each of the over 700 districts and the rural sector, key to both inclusion and employment.

RANGE OF SCHEMES

There is also a range of schemes as measures to improve access to credit and working capital. This is in addition to special schemes for the micro, medium and small-scale sectors. The tax regime has been made more generous for the world’s third largest startup ecosystem. With an eye to the future, the government has allocated US$1.2 billion for five years for a National Mission on Quantum Computing and Applications.

The financial sector has been under stress. It has, therefore, received the maximum attention in the past year. Around US$50 billion has been injected into the public sector banks (PSBs) in recent years, including US$10 billion early in the second term. PSBs have been consolidated. The budget builds on a slew of recent measures to restore the health and liquidity of non-bank finance companies.

New measures for deepening the bond market will increase access to finance. Some of the measures will benefit foreign investors, such as eligibility to invest in certain government securities and the increase in limit of Foreign Portfolio Investment (FPI) in corporate bonds from 9 to 15 per cent of total. Last year, overall FPI investment limits in companies were substantially raised, and the range of investment avenues expanded. This budget further extends concessional withholding tax rates on interest income for foreign investors. A new measure introduces 100 per cent tax exemption on dividends, interest and capital gains for sovereign wealth funds for investments infrastructure and certain other sectors up to 2024.

Indeed, this budget reinforces the broader trend of enhancing the role of private sector and foreign investors. This year, high profile disinvestments have been announced – in line with the bold vision presented in the budget of 2019 on disinvestment in Central Public Sector Enterprises. Disinvestment is not principally motivated by fiscal needs. It is part of a vision of a more efficient and productive economy. Furthermore, this budget signals Public Private Partnership not just in infrastructure, but also in areas such as hospitals and agriculture logistics.

The focus on reviving growth is accompanied by undiminished emphasis on inclusion and empowerment, with a new national US$50 billion mission of bringing potable water to all, record outlay on affordable health care, a comprehensive 16-point agenda for agriculture, a more ambitious target for affordable rural homes and sharp increase in allocations for programmes for religious minorities. Taking India's digital revolution further into the villages, Fibre to the Home connections will link 100,000 village councils. Higher education has received significantly higher outlays, and the sector has also been opened for foreign investments and external borrowings.

TEMPTATION TO SPEND

As growth slowed, there is temptation to spend our way to growth. But that has its perils, as the past decade showed us. Fiscal prudence remains a touchstone. With a generous scheme to settle old direct tax disputes, we expect to maintain fiscal deficit within target range.

Growth will return. The underlying determinants – demography, size, scale, governance, policy, human resources, innovation and enterprise – point to that. The disruptions of path breaking reforms are behind us.

But, our objective is equally to fundamentally change its direction – clean up the economy, make it healthy, resilient, innovative, efficient, more integrated and digitalised, more inclusive and sustainable. The Centre cannot do it alone. States will be partners in this endeavour. And – above all – industry, farmers and workers are equal stakeholders.

More needs to be done and will follow. This Budget, however, keeps India on course to achieve our long-term vision as we head into the 75th year of Independence in 2022.

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