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Union Budget 2021-22: Expectations

Introduction

A statement of estimated receipts and expenditure, i.e., "Annual Financial Statement" of the Government of India has to be laid before Parliament in respect of every financial year from 1st April to 31st March. Hence, in this sense the budget is routine. But the budget provides an indication of the state of the economy, priorities of the Government and the use of instruments to realize identified objectives, influence direction and pace of the economy. Hence, budget, which is a document of estimates based on assumptions and strategies to achieve those estimates, is much more than a public statement of expected government revenues and scheme expenditures over a period of one year.

Difficult Backdrop

The forthcoming Budget would be presented against the backdrop of difficult domestic and international scenario-this is a time like perhaps no other in a century. The gravity of the macro-economic situation is manifested in the fact that this is the first recession in independent India and there have been only four instances when budgets have been presented in times of negative growth — 1958-59, 1966-67, 1973-74 and 1980-81. The enormity of COVID19 crisis makes the ascent long, uncertain and uneven. The triple whammy of contracting GDP, shrinking revenues and rising Govt. expenditure generate high budgetary expectations. The real and worrisome demand destruction concerns necessitate unleashing "animal spirits".

Three growth engines—private consumption, private expenditure and exports—are sputtering. The fourth and only functional engine, government expenditure, is working. The government has already announced a stimulus of Rs 29.87 lakh crore, amounting to 15 per cent of India's GDP, including Rs 8 lakh crore of RBI intervention to boost money flow. Slashing of the other five big heads—interest on loans, defence, food subsidies, pensions and transfers to states—which constitute over 60 per cent of the budget- is inconceivable.

The Covid-19 pandemic has created a "catastrophic" impact on the entire global economy during 2020, and India is also not insulated from its adverse impact. The effect of this is yet not over, despite the advent of the so-called "Covishield" and Covaxin" vaccines.

The Indian economy, as a consequence of such disaster has experienced a massive negative (-) 23.9 per cent GDP decline in the first-quarter (April-June), of 2020 and further to negative (-) 7.5 per cent in the second-quarter (July-September) of 2020; whereas the first Advance Estimate (AE) of GDP for FY21 came out as a negative (-)7.7 per cent. There is the real and worrisome concern of the first recession in Independent India. Supply-side disruptions have also fuelled higher inflation, therefore putting Indian economy in a double-whammy with lower economic growth and higher inflation. There has to be an accent on spending as in the wake of the global economic crisis of October 2008 with a fiscal deficit between 5 and 7 per cent of the GDP. Priority expenditure areas are health, infrastructure and urban unemployment.

Fiscal Deficit

The major challenge before the government is a deteriorating fiscal balance and an increasing fiscal deficit. The 2020-21 Budget did commit to a 3.5 per cent of GDP fiscal deficit target. However, as a fallout of the Covid-19 pandemic, the economic scenario has become fuddled, and the fiscal deficit reached 135.1 per cent of FY21 target in November 2020. Further, deficits of both center and states are bound to increase due to inclusion of off-budget items and higher capex, and other expenditure commitments for extending the vaccination programme, providing income support to the poorest, recapitalization of banks (if not by any other schemes like aggressive asset sale or any other schemes like "bad bank") and other unanticipated expenditures. The Centre might follow a relaxed fiscal roadmap to bring down the budget deficit to 4% of GDP by 2025-26. This shall require amendments to the Fiscal Responsibility and Budget Management Act.

Despite fiscal constraint, it has to be realized that higher capex (non-defence) to increase investment in construction and infrastructure is a prerequisite to broad-Based development. Beneficial repercussion effect will depend on the quality of expenditures in coming years, which has the potential for employment generation and enhancing economic growth. Accordingly, a moderate relaxation of fiscal deficit target can also be tolerated (with a credible remapping of fiscal consolidation roadmap), and even the Centre and States' debt/GDP ratio can be revised upwards given the current pandemic with wide-ranging adverse impact on many sectors in a sustainable manner.

Resource Mobilisation

On raising resources, the quantum of global liquidity and buoyancy in global and Indian equity markets presents an opportunity to sell assets and plough the proceeds into real economy. The monetisation of government-owned assets in defence and non-defence sectors can be massive if done aggressively at the right price. Also, the disinvestment of public sector undertakings (PSUs), for which the government had set a target of Rs 2.14 lakh crore in 2020-21, achieved only a measly Rs 11,006 crore. There has to be a credible divestment path for commercially viable companies to realize the avowed Budgetary and macro-economic objectives. The BSE is at the historic level of 50,000 and there is enough liquidity in the market.

Given the serious resource crunch, the Budget could identify additional revenue streams by utilising the existing resources. Closing chronic loss-making PSUs with huge accumulated losses saves money for the exchequer. The government also needs to review the steeply rising cost of the salaries of central government civilian employees, which currently stands at Rs 10 lakh crore (both central and state government employees put together, in 2017). Closure of some ministries and development of a robust bond market to attract foreign investment would be welcome. The idea of bad bank can be successful only when it is managed by professionally trained financial experts drawing inferences from international country models (e.g., "Danaharta" of Malaysia or "Retriva" and "Securum" in Sweden during Swedish banking crisis of 1992 when the Swedish authorities engaged McKinsey & Company to help design a solution of the Swedish banking crisis of 1992). Also, it should be designed in line with the model of National Investment Infrastructure Fund (NIIF) which is a SPV raising resources from international private equities. Expenditure rationalization strategy can be explored to free up fiscal space.

It is desirable to sustain expenditures on relief programs including the MGNREGA, free food, direct cash transfer programs and other social expenditure programs amid the fiscal constraint, while it may be recollected that schemes like PM-KISAN cash transfer scheme will be difficult to roll back given it was initiated just before the 2019 elections. Gaps and leakages need to be plugged since an RTI revealed that ₹ 1,364.13 crore has been paid to 'ineligible persons' and 'income tax payee farmers' till July 31, 2020.[1] A major chunk of these ineligible beneficiaries belongs to five states -- Punjab, Assam, Maharashtra, Gujarat and Uttar Pradesh, as per the data.

Given that rural India has emerged as India's growth driver amid the slowdown in urban sector, further push towards rural revival is imminent both from the perspectives of uplifting growth and orienting economic policy towards employment-intensive sectors. Income generation in rural sector will act as a catalyst for demand driver for commodities from Urban India (e.g., FMCG) and also helping in multiplier effect to take place in augmenting both economic growth and employment generation. Urban unemployment, which increased to 8 per cent in December, requires an urban version of MNREGA or the Mahatma Gandhi National Rural Employment Guarantee Act to provide jobs and social security. With limited fiscal space available, instead of big-bang capital outlay, the Union Budget 2021is likely to focus attracting more foreign direct investment (FDI) into India for more job creation. A national e-commerce policy[2] could be introduced with a more liberalized FDI regime in many sectors like – single brand retail trading, contract manufacturing, coal mining, digital media etc.

Among various sectors, computer software and hardware has seen most inflow, followed by service sector and trading. FDI norms could be relaxed further for IT, telecom, pharma, automobiles, chemicals etc. The export market is a key driver of employment generation, and to be leveraged through a policy supporting greater participation in the global value chain with rationalization of tariff regime and diversification of export base to capture more international market for exportable to exploit benefit from global markets.

Probable Outcomes/Industry Expectations

Atmanirbhar Bharat

India might increase import duty by 5-10 per cent on more than fifty items including smartphones, electronic items, and appliances which is part of the government's self-reliant India campaign or "Atmanirbhar Bharat" to support domestic manufacturing. Government seeks to raise additional revenue of about Rs. 20,000 crore amid the pandemic-driven slowdown through such move.

However, such duty hikes may impact furniture and electric vehicles, potentially might impact Swedish furniture maker IKEA and Tesla, which plans to launch their cars in India this year. Also, such "Atmanirbhar Bharat" strategy should be designed carefully and strategically, so as not to generate any adverse impact on terms of trade, instead with enhancing strategic partnerships with countries further via whom India can benefit (i.e., better terms of trade, higher export realisations, larger market access etc.). Further there is the expectation that the government may exempt tax on long-term capital gains (LTCG) arising from sale of listed equity shares. There are issues, such as, defining long-term to two years and the charge of taxation to zero. The government may re-examine tax laws that deal with withholding tax on dividends for foreign portfolio investors (FPIs). At present, companies withhold tax at the rate of 20 per cent plus surcharge and cess on the dividend paid to FPIs, even if they invest from a jurisdiction that provides for a lower rate based on India's double tax avoidance agreement.

The textile industry has demanded implementing a uniform GST structure for apparels and textiles to address the problem of higher duties on inputs and abolishing anti-dumping duties on viscose staple fibre (VSF). In the last Budget, the Finance Ministry removed anti-dumping duties on purified terepthalic acid (PTA), a crucial input in the manufacture of textiles fibres and yarns which though impacted certain domestic manufacturers of PTA, e.g. Reliance Industries, JBF and Indian oil but benefited many fibre, yarn and garment producers who could source the input at a much cheaper price. In November 2020, the GoI withdrew anti-dumping duty on acrylic fibre to enable sweater and shawl manufacturers get the raw material at competitive prices. At present, man-made fibre is taxed at 18 per cent, spun yarn and filament yarn at 12 per cent. 3

Removing existing structural glitches e.g., in GST, many instances have shown tax credits have been blocked due to technical glitches on the online GSTN portal (say while filing relevant GST Tran-1). Rationalization of rates (especially reducing highest 28 per cent for certain intermediate goods) is also needs to be explored. Again, real estate is suffering from unreasonable distinction carved between those who developed property for sale as against others who use it for commercial leasing. While the former is allowed to avail input tax credit, the later suffer the bar imposed under GST.

MSMEs

Social, infrastructure sectors likely to be key focus areas of government in the first post-Covid Budget with MSMEs being an integral element of the growth strategy. The vision of an Aatmanirbhar Bharat rests on the twin principles of scale and standards. The government must devise innovative ways to boost new micro-enterprises in rural India to create more employment opportunities outside agriculture. Building the entrepreneurial capability of rural youth through business training, easing the norms to start businesses, and creating a fast loan disbursement mechanism for micro-enterprises in villages, can help infuse new entrepreneurial energy into villages. To facilitate greater credit flow to MSMEs, the government might introduce certain schemes, among other incentives, specific to MSMEs, which would provide interest subvention for small-size MSME loans, resulting in more liquidity and credit inflow in the ecosystem.

MSMEs have to pay 18 percent GST to adopt digital solutions. Doing away with this or at least bringing it down considerably will reduce the cost of doing business, propel tech adoption and lead to improved efficiency and greater transparency. The government can provide further policy support to MSMEs to tide over the recessionary phase, revive the economy, ways to increase consumer demand, particularly in sectors that were hit hard by the COVID-19 crisis. The government must find ways to infuse more liquidity into the system, leave more money into the hands of consumers, and further ease the process of fund disbursement to MSMEs.

A less cumbersome GST structure and ease of taxation for MSMEs should also be a priority. Government should extend credit facilities to MSMEs and provide means for new-age technology adoption. Rigid regulatory compliance and tax burdens should be revised, which can provide impetus for growth and expansion. This will increase hiring and businesses can largely contribute to the GDP. Revised tax policies, less complex GST structure and relevant policies that provide thrust for digital innovation can incentivize home-grown start-ups and brands. Such a solution can help MSMEs to operate in a more level-playing field which has MNCs and other established players.

The Credit Guarantee Fund Scheme for Micro and Small Enterprise is currently providing the Limit upto 2 Crore only to the MSME Units. It may be amended so that the maximum benefits can be taken by the MSME Units in order to streamline their businesses. This should be amended upto 10 Crore or 20% of the Net Sales (whichever is less).

The Indian start-up ecosystem has played a catalytic role in the process of growth and structural transformation. In conformity with the recent production linked incentives (PLI) schemes for many sectors, a performance-based scheme (e.g., with parameters like sustainable employment generation and social contribution) can also be explored to provide further incentives for economic growth. Reduction in personal income tax rates or other taxes seems unlikely given the fiscal constraint; but enhancing capital expenditures and schemes like MNREGA could be effective, especially incentivizing rural sector.

Trade: Protection through tariff is an age-old concept in international trade. Protection is required for domestic infant industries for their development. Expansion, modernisation and competition should go together.

Service Expansion: India, at present, has dearth of warehousing and cold storage facilities, rural communication services, micro-insurance services, institutional micro-credit facilities, micro-level food processing in organised sector, rural health facilities, micro-irrigation, etc. All these sectors need urgent attention.

Productivity: Merger of small units and large units would definitely improve productivity as it leads to re-orgnisation of skilled manpower, reduction in operating cost, effective utilisation of fixed resources, greater market potential, effective implementation IT-Services like ERP System and promotes innovations.

Investment

• Complete removal of barrier for FDI investments in Healthcare, Telecommunication, Asset Reconstruction Companies, Insurance Business, all Types of e-commerce, Start-up and Venture Capital Investment, Export-oriented Automobile sector, Electric Vehicles manufacturing companies.

• In aviation sector 100% FDI is allowed. But there is a strong case for all aviation related activities should also be complete free for FDI.

• To export defence related items and to restrict our defence imports, 100% FDI should be allowed to defence related production.

• FDI, on manufacturing business that export at least 50 per cent of should be completely make free through automatic rout.

• Foreign companies are expected to take some constructive steps for the creation of agriculture supply chain. Entry of foreign players, agricultural infrastructure such as irrigation facilities, warehousing and cold storage will improve the productivity of the sector significantly. Hence, we recommend 100% FDI in agricultural related infrastructure including agricultural retailing, crop insurance, warehouse, cold storage, irrigation, organic fertilizers, equipment, etc.

• In railway transportation, India should go beyond PPP model and allow FDI in high-speed railway network, design and commission of high-speed engines, signalling system with domestic players' participation upto 25% and FDI 75%.

• In financial services sector, 100% FDI in automatic rout should be allowed for Insurance, Asset Reconstruction, domestic exchanges, all types of NBFC, private banking system, Small finance companies, Technology oriented payment system companies.

• The services sector, under non-finance, is the dominant sector in India's GDP. It also attracted significant foreign investment flows, contributed significantly to exports as well as provided large-scale employment. 100% FDI should be allowed under automatic rout for real estate, hotel and restaurants, transport, storage and communication.

Services (media and entertainment, IT-ITS):

1. Government should establish a separate agency for informal sector enterprises.

2. Informal sector should be granted as an industry status for institutional finance facilities.

3. 10 Year tax holidays should be provided to these units.

4. Compulsory purchase facilities and raw materials reserves purchase facilities should be provided.

5. Labour law relaxation should be provided.

6. GST exclusion principle should be provided to them.

7. Informal sector Zones with facilities like training, transport, warehouse, testing and lab facilities etc., should be established by government for location of these enterprises.

8. Banks should be asked to provide 1% of their credit to these informal enterprises.

Healthcare Reforms

The government needs to hike its health spending from the current 1.5 per cent of the GDP to at least 2.5 per cent to strengthen its medical infrastructure. Accordingly, the government must strengthen the health reforms to boost domestic health infrastructure, provide jobs, and increase health Insurance penetration with additional tax benefits. This necessitates adoption of an extensive, multifarious allocation and investments plan. While building a strong infrastructure, it is essential that in Budget 2021 additional funds be specially allocated towards training medical staff, establishing and improving the supply chain of vaccines, medicines and accessibility.

To meet future needs of quality healthcare infrastructure, it is imperative to increase the overall budget allocation to this sector. The idea of Atmanirbhar Bharat should be further amplified by supporting local innovations in the field of drugs and medical devices, provision of quality healthcare access in rural India through e-health/e-medicine services. Funds must be allocated towards skill development of teachers, nurses, paramedical staff, and caregivers. Affordability of healthcare and bringing Ayurveda under Ayushman Bharat are also needed. Attempts could also be made to increase the ambit of Ayushman Bharat PM-JAY, support Innovation Adoption and Scale-up and focus on Skill Development in Healthcare Space.

Technology

In the evolving new normal, technology has to be a thrust area in digital adoption and business continuity by operative and promising policies that not only support innovation and business continuity but create a robust digital ecosystem. Towards this end, there has to be a focus on formulating essential regulatory guidelines and incentivize R&D of new-age technologies like Artificial Intelligence (AI), Machine Learning (ML), Blockchain, etc. to digitize B2B processes at scale – speed, costs, and productivity. Companies doing business in India have a tremendous opportunity to leverage AI across the B2B process flows right from purchase order (PO) to payments and reconciliation. Manual processes are in-efficient in terms of a cost and time perspective. E-invoicing will also help address the key issue for MSMEs– getting paid on time, besides enabling digital lending through cash flow, payment, and invoice data.

Banking Sector

There are likely to be several measures of interest to the banking sector in India. Loans at affordable rates and a continued moratorium on loan payments (to the extent the stresses of COVD-19 are continuing) are expected. But the banking and financial sector is under severe stress itself, and the costs of deferring interest and principal payments under moratoriums schemes cannot be absorbed by lenders over the long haul. To the extent subsidies and additional relief is needed, these will need budget. To promote digital payments and improve credit accessibility, the industry is hoping that the government will continue its agenda to improve internet infrastructure and connectivity in Tier II and Tier III cities to support digital payments across these geographies. Digital literacy and financial literacy are critical to pushing the next wave of digital payments.

Hence the government should consider offering tax breaks and incentives to platforms that invest in customer awareness, digital literacy and financial literacy initiatives. To lower the cost of customer acquisition and help increase financial and credit access, the government should operationalize the centralized KYC database.

What is required is expediting the ongoing projects which are getting stuck for various reasons, coupled with clearance of subsidy arrears, pending dues to contractors and vendors and expediting tax refunds. Expedition of schemes like affordable housing (including housing and construction) has the potential to absorb both skilled and unskilled labour with high multiplier effects which can address rural employment generation and poverty to some extent, while resources may be earmarked to employment guarantee schemes like MNREGA to address urban unemployment issues. Such measures could beneficially impact the economy as the pandemic has adversely impacted the self-employed, informal sectors, smaller enterprises and contract-intensive jobs. In a nutshell, small-scale labour-intensive projects need to be identified which have much employment generation effect e.g., textile or handloom industry. Job-related schemes are likely to be more effective instead of direct cash transfer schemes given its potential for both job creation capacity as well as augmenting higher consumption demand.

Infrastructure

The government needs to restart its National Infrastructure Project (NIP) to spend Rs 111 lakh crore on 7,300 projects until 2025 and pay its pending bills. Infrastructure project financing in India is predominantly from the banking sector and a few infrastructure NBFCs. To strengthen the existing infrastructure NBFCs for enhancing their ability to finance projects and ensure completion of the National Infrastructure Pipeline (NIP) by 2025, the Union Budget could significantly increase the capital outlay towards infrastructure and also announce steps to boost infrastructure financing avenues and private sector participation.

The NIP financing plan includes sourcing 2-3 percent financing from a new DFI. It is likely the government would allocate equity funds towards this in the upcoming budget. With a revamped structure and a sizeable equity capital it can leverage to provide significant funding for the infrastructure sector. Further, increased facilitation of innovative mechanisms such as loan securitisation, InvITs, etc. can also help enhance infrastructure capital. In addition, the National Investment and Infrastructure Fund (NIIF) can play a big role in channelising long-term funds – both debt and equity - to the infrastructure sector.

Construction contractors are constrained by the availability of bank guarantee (BG) limits, which are required throughout the project lifecycle. For availing BGs, the companies have to provide collateral securities and provide margin money. Thus, without adequate BGs, neither can bids for new projects be made, nor can the contracts be efficiently executed. The Central government had recently taken measures to reduce the BG requirement. But this was done for a limited period and more policy initiatives are needed. Sureties (generally provided by insurers), a contractor-wise revolving BG provided to employers, could be used as security for multiple contracts may be considered. Some Income Tax relief by raising income tax slabs for the common man is expected. Also, crude could come under the Goods and Services Tax (GST) umbrella. Further, reduction in entertainment tax, incentives to give a boost for setting up manufacturing hubs and push for infrastructure spending are on the anvil.

Concluding Observations

Given the devastating hit to the Indian economy by the COVID 19 pandemic, the accent has to on increasing investment, creating externalities towards improving economic environment, and increasing productivity for a sustained high growth. Growth and distributive equity must receive a renewed thrust by a sharper focus on infrastructure, manufacturing, mobility, technology and urbanisation. In a deft balancing act, the FM is expected to reconcile the objectives of economic growth and distributive equity. While aiming at higher growth rate, the FM in this growth supportive Budget could stress agriculture and farmers' welfare, the rural sector, raise farm budgetary allocations, MGNREGS and various other rural focused schemes to revive rural growth.

ENDNOTES

1. Money Under PM-KISAN Scheme Going In 'Wrong Hands', RTI Data Reveals'(10 January 2021) Outlook India.
2. "FM may roll out red carpet for FDI" (23 January 2021) The HinduBusinessLine.
3. The HinduBusinessLine (20 January 2021).

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