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Budget 2015: Highs And Lows

On which counts did the budget deliver, on which did it look promising, and on which did it fail?

Arun Jaitley began his budget speech when Sensex was at 28900 levels. Ninety minutes later, when he finished his speech, the market was down 500 points. The market did recover later as the players read more fine print. I see two revolutionary points, many positives , some neutrals and a few negatives.

The revolutionary points are - fiscal federalism, transparent coal auctions.

The positives are - Black Money law, gold monetisation, alternative investment funds, REIT rules, EPF/NPS choice

The neutral issues are - 3% fiscal deficit, SEBI FMC merger, Public Debt management issues,

The negative ones are - middle class let down, IT Jobs and Minimum government Maximum governance

REVOLUTIONARY

Fiscal federalism

The 14th Finance Commission has to be congratulated for enhancing transfers to the states from 32% to 42% of the Centre's revenues. Of course the Commission was aided by a loophole in the terms of references compared to the terms of 13th Finance commission. Modi government was gracious enough to accept he recommendations. The Centre has recognised the growing power of states and has begun a new chapter in cooperative fiscal federalism. The Centre now devolves almost 62.5% of its resources to states and lets them decide their own schemes. This is a revolutionary idea that was implemented at last. Modi deserves a lot of credit for this.

Coal and power auctions

The government's major achievement is auctioning coal mines in a transparent way. During the last decade, the mines were allocated at a throw-away price. The auctions proved the lakh crore-plus loss calculation of CAG in respect of coal allocations of the previous PM to be correct. The Modi Government has proved its faith in transparent methods. It should do the same for all other minerals, power plants and large infrastructure projects. The money follows transparency and the government will not feel any deficit.

POSITIVE

Black Money

Modi government has done well to announce a law to unearth black money. Not declaring foreign assets would now be criminal offence, with up to ten years rigorous imprisonment. The

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implementation can be however tricky and needs careful thought. Income tax was so far never treated in this fashion. Care should be taken to ensure that software professionals who might have foreign bank accounts are not harassed. If not implemented carefully this might lead to undue harassment of small IT assesse and leave out large offenders, while also making tax officials richer.

A provision where FM wants to exercise control by encouraging Rupay debit card transactions seems to be somewhat careless drafting. Jan Dhan account holders struggle to have two square meals a day and thinking about black money in such people is strange.

Gold Monetisation

The FM has done well to announce gold monetisation to reduce black money and bring out the gold that is not creating any money supply. At the moment the poor have been pledging their gold rings, bangles to get a loan from Mannapuram kind of gold loan NBFCs. The poor man has already started monetising the gold. Most of the middle class have kept it in bank lockers and usually withdraw it for attending marriage functions. Most unaccounted gold belongs to rich and politician types. Whether they will bring this out will depend on how the scheme is structured with appropriate tax amnesties.

REIT Rules

The FM has offered tax breaks for REIT both at investment and dividend distribution level. As we all know Indian real estate developers with enormous political support keep building lots of apartments and commercial buildings. Bangalore has at present two years of unsold inventory, yet no one brings down the apartment prices. Quite often these projects receive politicians' black money and thus the builder is able to withstand negative inventory build-up. Earlier banks used to bail everyone out, but of late the RBI Governor has made it tough for banks to follow old practices. Thus the real estate developers were in bad shape. They can now parcel their properties as REITs and sell to foreign and domestic investors. Builders have this new life line and the prices will not come down any soon. At the same time real estate activity is expected to pick up with new REIT money.

EPF or NPS?

The government has done well by offering choices in terms of EPF, NPS as well as ESI. Both EPF and ESI were labour department schemes and were introduced long time ago. Dealing with these agencies is still difficult though the EPF has become much more productive and responsive to subscribers. Offering alternatives makes the public institutions more efficient.

Alternate Investment Funds

Alternative investment funds will be eligible for pass through exemption on income. This reform will attract more funds from the foreign players. The Government has encouraged REITS and Infrastructure investment trusts by making both contributions and dividends tax free. This is a welcome news for real estate and infra developers.

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NEUTRAL

3% Fiscal deficit?

The FM is apologetic about Gross Fiscal Deficit target. He has brought it down to 3.6% this year, by cutting down the government expenditure drastically in the last few months. He would like to bring GFD down to 3% in two years. India's public debt stock is just 45% of GDP compared to the US which is at 88%. The US economy is mature with lot of infrastructure already built and the economy having many low growth firms. India is a young county with lot of growth potential. India lacks infrastructure and needs enormous investment. The 3% GFD target may be appropriate for US and European economies. For growing country like India, the GFD will be much higher. The FM need not be apologetic about GFD and must provide funds for long term projects. He seems to have succumbed to the pressures of international credit rating agencies who don't understand India and usually set fiscal deficit target too low in comparison with developed countries.

Public Debt management office

The FM plans to set up PDM office in Finance Ministry. The proposal may not make much difference to debt market and PDM is better left with RBI, which is in day-to-day touch with the banks. RBI controls both SLR and CRR and can vary these parameters and manage public debt. Presently the public debt is mostly subscribed by compulsory SLR rules. The RBI can gradually reduce SLR and build a vibrant public debt market dominated by private banks and foreign funds.

FMC and SEBI merger

FMC and SEBI which were separate have been merged. The merger was not possible when Sharad Pawar was at the helm of Food and Consumer Affairs. Many countries have different regulators for banks and exchanges. Sometimes one regulator is too good and the other one not so good. The banks in the US could be licenced by the OCC, the Federal Reserve as well as the banking department of the states. India being a federation of states, one could try with allowing some regulatory arbitrage, considering that the new government likes federal structure.

Infrastructure

The Centre has much less fiscal space and the budget has not been clear on how the resources will be realised. The budget allocations are very nominal. They have been made big by counting PSU investments in infrastructure. The IRFC will fund railways projects and the NHB will create housing units. For other sectors, India needs lot more funds and the government must be the first mover in such risky projects. Lot of reform in PPP is needed, but not spelt out.

NEGATIVE

Middle class let down?

The FM looked at Mallikarjun Kharge, the Congress leader and said that the MNREGA – the rural employment schemes — outlays have not been reduced. Special schemes for Minorities in the form of 'Nai Manzil' was introduced. But the tax exempt income for middle class was not increased. Usually every middle class person would like the FM to increase the tax exempt income. This time people were expecting it to go up form Rs 2.5 lakhs to Rs 3 Lakhs. The FM has not done that and instead he has introduced many new tax deductions totalling up to Rs 4.3 lakhs. That does not make any difference to a person who does not earn even Rs 2.5 lakh per year. In spite of Delhi

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defeat, it is strange that the government did not feel it fit to take this class along.

IT Jobs

The IT industry, with of exports over $100 billion, has created over 40 lakh direct and 200 lakh indirect jobs. The situation is quite grim for the 15 lakh engineers that India produces every year. Even 20% of them don't get jobs. One can expect closure of large number of engineering colleges. Newspapers reported TCS layoffs but large scale layoffs are happening in many firms. This sector is no more vibrant as it used to be. Parents dreamed of theirs sons and daughters in IT firms, buying new cars and houses. That has stopped for now and the inventory of housing stock is at a fairly high level. The FM has ignored this sector and has mentioned it in the para concerned with issues of start-ups financing.

Minimum government maximum governance

This Modi mantra is usually understood as benefitting the common man. People imagine that common man will be able to get his passport in a week, caste certificate would be issued under self-declaration, municipal bodies would accept taxes via internet etc. This could be achieved by bringing a central act to apply time limits for each permission, improving productivity via e-governance etc. However the budget refers to this phrase with respect to complex tax transitions where common man has no role. The meaning of the phrase will get diluted if used everywhere without showing credible results.

The market has reacted with shock, fell and then went up again at close. The Sensex is already over valued and we might see corrections during coming months.

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